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WELFARE REFORM

Support For Welfare Reform: The motivations for state officials, the federal government, taxpayers, compassionate citizens, and profit-maximizing business leaders to be concerned with reforming welfare are all strong.

Welfare remains consistently and thoroughly unpopular, as shown by every public opinion poll looking at the question. Working people and people living on pensions they earned by working simply don't like the idea of paying money to able-bodied persons who don't work. The sympathy for paying for mothers of young children to stay at home with their children has been eroded as more and more taxpayers discover they cannot afford to have a parent be a full time homemaker. There is considerable indication that welfare recipients themselves hate the system, viewing themselves as being "trapped on welfare." There is overwhelming evidence that the consequences for children of growing up in welfare households are undesirable in just about every dimension.

Federal and state officials lament the costs of welfare and the expensive income-tested, oft-criticized programs (e.g., public housing, Medicaid) that accompany it. They lament the loss of revenue because potentially productive people are not working. So do business leaders who in broad terms are starting to worry about a labor shortage and in narrow terms don't understand why they can't get applicants for lower wage jobs while many people who could take them remain on welfare. To top it off, even the professionals, such as caseworkers, have a loathing for their work unmatched in the aggregate by highway workers, teachers, health care workers, and workers in traditional private sector jobs.

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Some of these criticisms are not new. They used to be considered "conservative," but are now appearing from all points on the political spectrum. The problems with welfare and with the new welfare reform legislation were anticipated in a special NCSL conference last year (see "Beyond Welfare" in Issue 11). The criticisms have produced an environment in the legislatures that has kept welfare grant levels from being raised to match inflation, even in years when state finances have been in relatively good shape. In a year like 1991, they are likely to make increases in AFDC and general assistance grant levels a rare phenomenon in state budgeting.

The Latest Reforms: Small wonder that considerable energy has gone into programs designed to take people off the welfare rolls and put them onto the job rolls. Federal initiative for decades produced an alphabet soup of these as the latest approach not to work was replaced by the newest approach with its hopes that it would work. All of this was to end as state officials seized the initiative with new programs like ET in Massachusetts and GAIN in California. The highly touted results were followed by programs in other states and federal adoption as a requirement. The federal legislation marked an end to a debate that had gone on for decades over requirements that welfare recipients work. Liberals, who had opposed work requirements, agreed that all recipients but those with the youngest children would be required to work or at least prepare for work. Conservatives agreed that the work requirement wouldn't be punishment for being on welfare or a threat to recipients but a chance for a better life by escaping the trap of welfare dependency.

Two kinds of glue held the agreement together. The first was the promise that the provision of education, child care, job preparation and counseling, continuation of benefits after employment for a transition period, and job placement activities would be cost-saving or at least cost-neutral -- if not in the first year at least over time. So the savings in reduced welfare and other income-tested programs would, over time, equal the outlays to make welfare recipients ready for work and find them jobs. The second bit of glue was that, in practice, the work requirement would be contingent on the social services. That is, the welfare recipient wouldn't be expected to work if the states couldn't or wouldn't provide the supporting services called for by the plans.

What Appears To Be Happening: There is still dispute over how helpful the state strategies for putting welfare recipients to work have been. There is no doubt that many people have left these programs for jobs. Nor is there doubt that many people leave welfare for jobs without these programs. To evaluate the effects of the programs it is necessary to match two comparable groups and see whether a larger percentage served by programs get jobs than those who don't receive the extra services. The subjects must be tracked for a considerable period of time because if the programs don't provide relatively permanent substitutes of working for welfare, they clearly

aren't cost effective. Getting many of these kinds of studies is difficult because they are expensive and inherently involve denying some people services while others similarly situated are provided services they want and program administrators say they need.

Without this kind of information, state officials can't easily tell whether the welfare reform programs save more in future AFDC costs than they cost for social service and education investments. They already know that -- in the short term, reflected by the budgets in any year -- the costs are additive. This is, by adding $1.00 in social services to help welfare recipients get work they can't subtract $1.00 in AFDC payments in the current AFDC budget. If they suspect they can't ever subtract anything, support for welfare reform funding tends understandably to dry up.

From Welfare To Jobs In New Jersey: The New Jersey legislature cut welfare reform funding in the 1990 legislative session. To find out the results, the House Appropriations Subcommittee dealing with social programs invited selected county welfare directors to discuss their experiences in an October hearing.

The welfare director of Essex County, which has 28% of New Jersey's welfare caseload, explained that a welfare mother needs to make about $8 an hour to "break even." Breaking even involves offsetting the cash benefit ($424 a month), federal food stamps, Medicaid, and some version of the transportation and child care costs associated with working. The average starting salary of the jobs being provided through welfare reform were, he said, about $6.20. He and the other county officials urged legislators to stop equating the success of welfare reform with statistics about the number of people getting jobs.

Welfare Rolls Increase: Welfare caseloads were relatively constant through the 1990s, so the primary cost increases for states were: (1) increases in cash grant amounts, generally below inflation and (2) increases in Medicaid costs for the welfare caseload, generally above inflation by a substantial margin. In the last year, there have been major increases in the AFDC population in nearly every state. For example, in December, Pennsylvania's welfare department announced that growing caseloads could produce a shortfall in cash payments of $87 million, plus the Medicaid shortfall associated with the higher caseloads.

California's long-term outlook, as calculated by the Commission on State Finance, is for a continuing increase in welfare caseload, with a 3.1% increase in FY 1992 and increases above 2% in the rest of the early 1990s.

The Alternative To Reform: Welfare reform, beyond what is required by federal law, can be abandoned by refusals to fund. In broader terms, it can be abandoned or deemphasized by emphasis on children directly rather than indirectly by seeking to assist the family unit. This sounds radical, but has already appeared in the Medicaid program. There, the family unit concept is being abandoned in favor of a concept of entitlement oriented toward children.

Because money spent on caseworkers who work with adult clients is money that could be spent on children, some advocates for children have questioned some aspects of welfare reform. For example, in commenting in October on state welfare policy, the executive director of the Association for Children of New Jersey commented, "My frustration is we've had federal welfare reform and state welfare reform and we still see hundreds of thousands of kids in poverty. Maybe we need to rethink how much of that money is being spent on a welfare bureaucracy and maybe we need to find creative ways to help these children."

Comparing State Efforts To Help Children: There are many different ways of assessing how well each state is treating children through state government policy decisions. The Children's Defense Fund uses 20 different measures. The result grades states highest if they have relatively generous welfare and medicaid programs and have made recent progress in improving on indicators like infant health. The scores appear on Table 1.

Table 1: Children's Defense Fund Report Card Scores. 1990

Rank	State	Score	Rank	State	Score	Rank	State	Score
1	Vermont	65	17	Alaska	35	31	Montana	25
2	Maine	60	17	Iowa	35	31	Nebraska	25
3	Massachusetts	55	17	Michigan	35	31	North Carolina	25
3	Minnesota	55	17	North Dakota	35	31	Oklahoma	25
5	Connecticut	50	17	Virginia	35	31	Oregon	25
5	Delaware	50		**United States**	32	31	Texas	25
7	California	45	23	Arkansas	30	31	Utah	25
7	South Carolina	45	23	Florida	30	31	Wyoming	25
9	Illinois	40	23	Hawaii	30	42	Arizona	20
9	New Hampshire	40	23	Maryland	30	42	Georgia	20
9	New Jersey	40	23	Nevada	30	42	Mississippi	20
9	New York	40	23	Ohio	30	42	Missouri	20
9	Pennsylvania	40	23	Tennessee	30	46	Colorado	15
9	Rhode Island	40	23	West Virginia	30	46	Idaho	15
9	Washington	40	31	Indiana	25	46	Kansas	15
9	Wisconsin	40	31	Kentucky	25	46	South Dakota	15
17	Alabama	35	31	Louisiana	25	50	New Mexico	10

CORRECTIONS COSTS AND RESULTS

Introduction: Growing corrections costs continue to be a major factor in preventing states from being able to finance current state services without tax increases.

The main cause of the problem is the growing number of prisoners. From July of 1989 to July of 1990, there was an 11.9% increase in the nation's prison population. It costs roughly $25,000 to hold a prisoner for a year in state prison systems. So the 80,000 increase in inmates costs about $2 billion. Over 90% of prisoners sentenced to a year or more are in state, rather than federal, institutions. Assuming that the 80,000 new inmates required building additional facilities at $55,000 a cell, another $4.4 billion was required for construction.

In addition to expanding prison capacity and increasing operating costs for new prisoners, many states are increasing the costs of their corrections systems in response to litigation about prison conditions. These have led to consent decrees in many states that commit the state to designated improvements in conditions and the costs associated with those improvements.

Differences Among States In Inmate Increases: The states show quite dissimilar patterns in the trends in their total prison populations. This suggests that there are significant differences in state policies affecting the results. Table 2 shows the most recent statistics.

An examination of Table 2 emphasizes the importance of state policy choices in determining the growth of correctional populations. If demographic or economic factors were at work, one would expect to find economically and demographically similar states with similar increases in prison populations. This pattern doesn't appear in the table. Illinois led the nation with a 21% increase, but neighboring Indiana had a 2.5% increase and Wisconsin a 5.5% increase. Texas had a 19% increase, but Oklahoma was under 7%. Kansas showed a decline while Nebraska showed an increase of nearly 10%. The New England states varied from 2.7% in Rhode Island to 16.3% in New Hampshire.

Table 2: Percentage Increase In Prisoners, July 1989 to July 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Kansas	-8.1%	18	North Dakota	7.7%	34	New York	12.3%
2	Mississippi	0.0	19	South Dakota	7.8	35	Maine	12.5
3	New Mexico	0.3	20	Minnesota	8.4	36	Idaho	12.8
4	Alaska	0.5	21	Alabama	8.7	37	Arkansas	12.9
5	Montana	1.7	22	Arizona	9.3	38	Kentucky	12.9
6	Indiana	2.5	23	Nebraska	9.6	39	Pennsylvania	13.1
7	Rhode Island	2.7	24	Wyoming	9.6	40	California	13.2
8	Nevada	3.2	25	Georgia	9.7	41	Ohio	13.5
9	Hawaii	4.3	26	Colorado	9.9	42	Maryland	13.6
10	North Carolina	4.4	27	Utah	10.2	43	Vermont	13.6
11	West Virginia	4.7	28	Massachusetts	10.3	44	Virginia	14.0
12	Oregon	4.8	29	Michigan	10.6	45	Iowa	15.7
13	Tennessee	5.4	30	Louisiana	10.8	46	Washington	16.0
14	Wisconsin	5.5	31	South Carolina	11.0	47	New Hampshire	16.3
15	Delaware	6.8		**United States**	**11.9**	48	New Jersey	16.5
16	Oklahoma	6.8	32	Florida	12.3	49	Texas	18.9
17	Connecticut	7.6	33	Missouri	12.3	50	Illinois	20.9

Incarceration Rates: Table 2 is a one-year snapshot of the increase in incarceration. The incarceration rate, shown on Table 3, reflects the number of prisoners related to population.

Table 3: Number of Prisoners Per 100,000 Population, July 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	North Dakota	66	18	South Dakota	184	34	Missouri	291
2	Minnesota	73	19	Idaho	193	35	Ohio	293
3	West Virginia	83	20	Colorado	206	36	California	303
4	New Hampshire	114	21	Tennessee	206	37	Mississippi	303
5	Vermont	115	22	Connecticut	223	38	New York	304
6	Maine	124	23	Kansas	224	39	Georgia	318
7	Iowa	135	24	Indiana	225	40	Florida	328
8	Massachusetts	135	25	Illinois	233	41	Delaware	333
9	Utah	141	26	Oregon	233	42	Maryland	339
10	Wisconsin	141	27	Wyoming	233	43	Alabama	348
11	Nebraska	147	28	Kentucky	237	44	Alaska	355
12	Rhode Island	151	29	North Carolina	261	45	Michigan	357
13	Washington	152	30	New Jersey	268	46	Arizona	369
14	Hawaii	159	31	Arkansas	274	47	Oklahoma	370
15	Montana	174	32	Virginia	276	48	Louisiana	421
16	New Mexico	181	33	Texas	280	49	South Carolina	443
17	Pennsylvania	181		**United States**	**289**	50	Nevada	463

The differences among states are massive. There are ten states that have half the ratio of prisoners to population as the nation. Many of these are predominantly rural states with a population somewhat older than the national average, but the list includes Minnesota, Massachusetts, and Wisconsin. Some states are strikingly above the national average. Nevada's high incarceration rate is presumably related to the large number of tourists attracted to the state, but such explanations don't explain the high rates in South Carolina, Louisiana, Oklahoma, Arizona, and Michigan. The cost implications are substantial. At $25,000 a prisoner year, South Carolina could save the costs of 6,888 prisoners, or $172 million a year, by moving to the same incarceration rate as North Carolina. By moving to the national average, it could save $146 million annually.

Jails: In most states, local jails are used for short sentences and holding persons awaiting trial. But there are differences among states in circumstances where inmates are sent to jail or prison and some smaller states (e.g., Connecticut and Hawaii) have combined local jails and state corrections systems.

Nationwide there were 144 persons in jail (1988) per 100,000 population. There is a definite regional pattern with the least use of jails in the Midwest (85) and the most in the South (171) and the West (185). Jail populations grew by 54% in the five years ending in 1988.

Probationers and Parolees: The increase in prison populations is paralleled by an increasing number of persons on probation and on parole. From January of 1981 to January of 1989, there was an increase of 114% in jail and prison populations. This slightly exceeded the increase of 107% of those on parole, but was less than the increase of 126% of those on probation. At any point in time, about three-fourths of all convicted offenders are under community supervision -- probation or parole -- rather than in prison. At the end of 1989, 4.1 million adults, about 1 in 46, was under the supervision of a corrections agency -- 62.2% on probation, 16.8% in prison, 11.3% on parole, and 9.7% in jail.

Patterns among states in probation policies vary substantially as shown for selected states on Table 4. The first column is the percentage change during 1989 in the number of persons on probation. The second relates the number of probationers at the end of 1989 to each 100,000 adults.

Table 4: Probation In Selected States, 1989

State	Pct. Inc.	Per 100,000
Florida	16.3%	1,964
New Jersey	15.3	1,131
California	7.3	1,335
Virginia	6.4	414
United States	5.6	1,369
Illinois	3.5	1,083
Minnesota	3.1	1,819
New York	2.8	946
Texas	0.8	2,419

Use Of Parole: The range of options being decided differently in individual states, presumably with substantial implications for costs and crime, is no better illustrated than by the use of parole. Nationwide, in 1989, the population on parole increased by 12.1%, roughly equivalent to the 11.9% increase in prisoners. But sharply different state policies constitute this national average. Major one-year decreases in the population on parole were made by states like Massachusetts (-13%), Rhode Island (-12%), Florida (-10%), Kentucky (-9%), and Washington (-8%). At the same time, the use of parole was greatly increased in Georgia (54%), Kansas (37%), Oklahoma (37%), Michigan (29%), Alabama (22%), Vermont (21%), and California (16%).

The variation in the parole policies of the states also appears on Table 5, which shows the number of persons on parole at the end of 1989 as a percentage of the adult population.

Table 5: Parolees Per 100,000 Adults, End 1989

State	Number	State	Number
Connecticut	13	**United States**	**248**
Florida	24	California	269
Arizona	80	New York	270
Indiana	84	New Jersey	340
Wisconsin	122	Georgia	376
Illinois	168	Pennsylvania	519
Alabama	191	Texas	758

Corrections In New Jersey: New Jersey is typical of the states where corrections costs represent bad news. The major tax increases of 1990, which have been highly unpopular, were aimed at other priorities such as relieving property taxes and improving the schools, particularly in areas with high poverty concentrations. Now, with revenues less than anticipated, major cuts are being discussed in other state programs to avoid another tax increase. In a recent seminar sponsored by the Partnership for New Jersey (a Business Roundtable-type organization), experts talked about an increase of 7,600 more inmates than current capacity -- $500 million or so in added capital costs and $190 million a year in operating costs. Panelists discussed reasons which included using stiff prison sentences for drug offenses and an apparent shift of parole authorities toward less generous use of parole.

Corrections In Illinois: Although there is talk in Illinois -- the state with the highest growth rate in prisoners shown on Table 2 -- that the state cannot build its way out of the prison problem, considerable building has been going on. From FY 1978 to FY 1990, the state added more than 11,000 prison beds by expanding existing facilities and constructing a dozen new ones. Current corrections agency projections show the inmate population rising from just over 20,000 in 1989 to over 30,000 around 1993 and 40,000 by the year 2000.

Dealing With Corrections Costs: Comparing costs of the corrections function among states is difficult because of differences in cost accounting among the states. For example, some states budget employee benefits, like health care and pensions, in central accounts while others include them with agency accounts. A New York study published earlier this year provided a comparison among major states that showed the cost differences shown in Table 6.

Table 6: Operating Cost Per Inmate, FY 1988

State	Cost Per Inmate	State	Cost Per Inmate
New York	$25,286	Pennsylvania	$14,054
Michigan	21,324	Florida	13,819
California	19,568	North Carolina	13,765
Illinois	18,613	Texas	13,142

The major factor affecting operating cost differentials is likely to be the pay of corrections officers. Differing staffing ratios are probably also a factor, but it is difficult to sort out in-prison guard staffing from overhead staff when comparing the corrections systems of different states.

EDUCATION CHOICE

Introduction: Interest in education "choice" plans continues despite recent rejections by Wisconsin courts and Oregon voters.

Federal Endorsement Of Choice: As one of his last acts before losing his job (replacement: former Governor Alexander of Tennessee), Education Secretary Cavazos announced the creation of a choice "outreach office." The new Center for Choice in Education will be a clearinghouse on the subject, complete with its own "hot line" (Call 1-800-422-PICK). For federal purposes, choice includes (1) private school options with public funding through tuition tax credits or vouchers, (2) home schooling, (3) special choices presented by dropout-prevention centers and the option given high school students to take college courses, (4) choices among school districts, and (5) choices within school districts generally and the special situation of magnet schools.

Education Organizations Oppose Private School Support: At about the same time the Education Department made its announcement, ten education groups announced their opposition to using public funds to support private schools. The groups included the American Federation of Teachers, the National Education Association, the National PTA, and various administrators' groups. Some of these groups support choice among public schools, at least in some circumstances, but feel support of private schools will weaken public schools.

Wisconsin's Plan: There are just under 400 Milwaukee pupils enrolled in private schools this school year under the state's new choice plan. The inner-city students are the nation's first to attend schools under such a plan, which developed out of a unique coalition of inner-city legislators and conservatives. While there have been some decidedly favorable journalistic reviews (see, New York Times, 12/19), it is much too early to assess educational results. There are many eager watchers, including the President, who has called it "one of the most interesting experiments in education reform."

The opponents of the Milwaukee plan, apparently led by the Wisconsin education department, mounted a court challenge. It lost in the court of first jurisdiction. On appeal, the opponents won on a procedural issue related to how the legislation was passed. It was attached to the omnibus bill that, in Wisconsin, as in some other states, wraps up the budget compromise and a variety of substantive legislation. This practice is subject to attack as violating constitutional requirements that bills deal with a single subject and that local benefit bills be voted upon separately from statewide legislation. On this ground, the Wisconsin appellate court rejected the legislation in a November decision. The next stop is the state supreme court.

Oregon's Educational Choice Measure: The educational choice measure was rejected by a two-to-one margin in Oregon. Because the measure combined two elements, it is difficult to categorize it as either representing a pure vote on privatization of government functions or choice movements for public schools, though it did represent a vote on both school choice philosophies considered together.

Conceptually, the measure was equivalent to the scholarship programs run by most states. The financial aid becomes an attribute of the student, rather than of the school. The student carries the aid entitlement to the school of choice, regardless of whether that school is managed by government, a private non-religious group, or a religious group. The policy argument for this choice was that it allows the student to match needs with educational offerings and forces providers to tailor their offerings to the perceived needs of students, tending to lead to efficiency in a marketplace sense.

One argument against the plan was that it would lead to subsidizing providers considered undesirable -- including state support of religiously oriented institutions (which now occurs with universities, hospitals, and day-care providers). Another argument was that the freedom of choice would lead to a concentration of hard cases and undesirable situations in central facilities, such as central city schools (which now occurs with central city hospitals). Opponents argued that choice would be ineffective for the poor because they couldn't afford transportation. Proponents argued the rich already have choice because they can pay tuition and transportation, so the measure is extending choice. Opponents contended that the schools would have the option of setting admission standards and would tend to "cream-skim" leaving the hard cases to the public sector.

The math of the proposition was hotly disputed in Oregon, but the underlying economics was relatively simple. There are already some students in private schools who would be there with or without subsidy. These students would give rise to subsidies of $2,500 per student, with a loss to taxpayers and a gain to those now paying of the amount involved. Those interested in public schools view this as a deadweight cost of the program, adding to taxpayer costs without changing anything. Others view it as a partial end to the free ride taxpayers have been getting from those who pay for education twice -- once as tuition-paying parents and again in taxes to support public schools their children don't use.

For students who would make the choice of private schools under the program, but wouldn't otherwise, the plan represents a savings of the costs of educating a child in the public schools, which is more than the subsidy, if the public schools adjust their spending proportionally to the change in enrollment, which school officials claim they cannot. The Oregon measure had a complex mechanism

designed to capture the state and local taxpayer savings and use them to offset the costs of the subsidy.

Because of doubts about the constitutionality of direct payments to schools, the subsidy was packaged as a refundable credit against Oregon's income tax. Proponents believed this puts it squarely within the precedent of the U.S. Supreme Court's approval of Minnesota's tuition tax credit. Opponents didn't agree. Had the measure passed, they would likely have litigated the issue as far as the court system would let them.

The other portion of the Oregon choice plan involves choice among public schools, including the transfer of both state and local taxpayer support among school districts when a student selects a school in another district.

The measure appeared to be slightly ahead in some of the early polling, but the campaign against it used most of its substantial resources just before the election. The opposition campaign stressed that the plan would involve turning public funds over to private groups with no control over the selection except whatever control might be exercised by the parents.

Choice In Other States: Some version of choice plans now exist in Minnesota, Iowa, Arkansas, Nebraska, Ohio, Utah, and Idaho. There is significant support of students attending private institutions in the Iowa and Minnesota plans. There are demonstration plans in some other states, such as plans adopted by Colorado and Washington this year.

SCHOOL FINANCE EQUALIZATION

The Statewide Property Tax: "I guess what I'm doing is running a flag up to see if we can get anybody to salute it." With this comment, Texas Senator Carl Parker, chairman of the Senate's Education Committee, presented a legislative package including a statewide property tax as high as 1% of assessed value. Enactment in Texas, which would require a constitutional amendment to eliminate the constitutional prohibition of state property taxes, isn't likely. But the concept of the legislation underlies many of the court decisions in the school finance equalization cases and illustrates the difficulties legislatures face in dealing with such cases.

In every state, there is wide variation among school districts in the property tax base for schools, measured by assessed value per pupil. As a result, equal tax efforts, that is, equal property tax rates, will provide unequal funding per pupil. If districts try for nearly equal results, they produce highly unequal taxes. For example, the richest district in Texas has a rate of about 0.25% of value while the poorest has a rate of 0.9%. Typical state equalization programs can mitigate these differences, but not eliminate them without prohibitive cost. The Texas program, adopted after numerous special sessions and a tax increase in 1990, mitigates them. As a result, the poor districts are back in court seeking more equalization. They have won at the lower court level and Parker sees little hope that the state supreme court will uphold the legislation he sponsored last year.

The statewide property tax eliminates the problem of disparate wealth per pupil by putting all the state's property tax base behind all of the pupils, providing equal wealth per pupil for all pupils. But if there is no local option to increase the rate, then local voters couldn't provide more school spending even if they choose to do so. To avoid this, Parker's proposal leaves room for a local option property tax on top of the state tax. Unfortunately, such a local option reintroduces disparities among districts based on their wealth per pupil. This is one of the reasons why state legislatures have such difficulty in finding school financing arrangements that they find acceptable that also prove acceptable to courts seeking complete equalization. So, besides Texas, New Jersey also finds itself back in court immediately after having adopted a major equalization plan.

Hawaii uses a statewide tax system for the support of all its schools, so it doesn't have an equalization problem. New Mexico gets to about the same result by mandating a uniform low-rate property tax in every school district. Just about every other state is vulnerable on school finance equalization criteria.

School Finance Cases: School finance cases are active in at least the following states: Alabama, Alaska, Idaho, Illinois, Indiana, Louisiana, Massachusetts, Minnesota, Missouri, Nebraska, New Jersey, North Dakota, Ohio, Oklahoma, Oregon, Tennessee, and Texas. There are probably others.

To prevail in these cases, plaintiffs must fulfill three basic conditions: (1) bringing the litigation through the trial stage and any appeals, (2) convincing the courts that the state constitution requires the state to provide roughly equalized spending in individual school districts, and (3) getting the courts to take action sufficient to require the legislature to act. Not all these conditions will be fulfilled in every state where litigation is a topic.

The decision to undertake litigation on school finance carries some hazards for the litigants. The action is costly to the districts involved. It will often incur the wrath of some of the other school districts and their teachers, as one of the potential results is to reduce state aid that would otherwise be available to them. In the process, it may destroy a united front in dealing with the legislature on school aid allocation issues -- carrying both the risk of lower school funding in total and the risk that the funding made available won't be favorable to the districts in court. The existence of litigation, particularly at the appellate stage, can also provide a rationale for relatively low school aid allocations as the legislature waits for the court's guidelines before infusing substantial new money into the school aid formula. For all these reasons, in some states it appears that districts are in a hurry to establish that litigation is being undertaken, but in no hurry to press for court decisions.

Getting a state court to decide that state constitutions require substantially equal per pupil spending, or equal spending with equal local tax effort, isn't easy either. The U.S. Supreme Court has decided the U.S. Constitution has no such requirement and about half the cases have resulted in comparable state court decisions. In the typical case, plaintiffs are trying to convince a state court that constitutional language to the effect that the state shall ensure that there be a system of free public education carries an equalization mandate. In Alabama's case, the problem is even more difficult as the language regarding the state's obligation to provide public education was eliminated from the state constitution at a time when the state was battling desegregation. It has never been reinstated.

Even if a state court system decides a school finance system is inequitable, quick remedies don't necessarily follow. In the Texas case, legislators were convinced (or acted as though they were convinced) that the courts would enjoin the distribution of aid under the old formula, thereby closing many of the state's schools. Some Texas legislators appear to have believed that the court would write its own school aid formula and find a way to require that funds be disbursed pursuant to it. But in West Virginia, it has been clear that the courts weren't about to attempt either of these remedial actions. The possibility for inaction on remedies are substantial. It typically takes at least a year to litigate a school finance case to final conclusion. During that year, the formula would likely be changed in the normal course of legislative action, creating a potential for a new decision on the merits and a new set of appeals.

Complexities In The Cases: As the courts have become more involved in school finance, the emphasis has shifted from relatively simple views of equalization to more complex arguments over such subjects as measures of need and of local fiscal capacity.

Local fiscal capacity is easily measured by the property tax base per pupil. But some districts, such as high income residential suburbs, may have more discretionary taxpayer income than districts with somewhat higher per pupil property tax bases -- or at least so it can be argued. Another problem arises when two districts have identical property value per pupil, but one shares its tax base with a high tax jurisdiction such as a central city while the other doesn't.

There is endless room for argument over how exactly "need" for education spending should be measured, once the concept that all pupils have identical needs for spending is abandoned. One of the major changes in New Jersey this year involved definitions of students requiring compensatory education. The new program defines "at risk" students by qualification for free school feeding programs, basically an income test that eliminates most suburban children. The old test was related to school performance, so it put considerable quantities of money into the suburban districts.

FINANCING HEALTH CARE

Stalemate In New Jersey: Having failed to resolve health care financing issues in 1990, New Jersey officials will try again in 1991.

> If we are going to cure the ills of the uncompensated care system, we must bring everyone who has something at stake to the table. As the crisis has loomed, we have heard many diverse views of what steps should be taken. The diversity of the views and the complexity of the problem show that a consensus must be reached to address the indigent care system.

With these words, New Jersey Speaker Joseph Doria announced that he had invited over 250 interested parties to a health care summit meeting in early January.

The Major Reform Plan: This fall, New Jersey legislators watched the options shrink from adoption of a health care plan that might set the pace for the nation's states to doing nothing, leaving health finance in limbo effective January 1. Health care had been the one major omission in Governor Florio's package of school finance equalization, tax reform, local government finance, and budget revision that passed earlier this year. The knotty health care problem was left to a Blue Ribbon commission that reported this fall with recommendations to move toward universal coverage. The main financing mechanism was a payroll tax of $144 per employee-year for uncompensated care plus over $1,000 per employee-year for employers who wouldn't provide minimum health care coverage for their employees.

Tax-shy legislators balked at the tax aspects of the plan. So did the state's major business organizations, despite the enthusiastic support of some of the business leaders who had served on the commission. Business groups argued that something should be done about cost controls before adopting a new financing plan. The state AFL-CIO has continued to press for the commission recommendations.

Stop-Gap Measures: Absent action on a new plan, the obvious choice was to renew the current Uncompensated Care Trust Fund beyond its scheduled expiration at the end of 1990. The fund gets its money from a surcharge of 19% on hospital bills. The rate would have gone to about 23% in 1991. The Senate voted to extend the fund for three months. But the House adjourned without action, a decision concurred in by Governor Florio. He called the current system "woefully out of control" and argued that it was better to "start the process of taking some action" than to preserve a system that hadn't worked. The financing of the Trust Fund is also under attack in New Jersey courts by the AFL-CIO and Blue Cross/Blue Shield. They contend the 19% surcharge is a tax and, as such, was invalidly enacted because the legislation originated in the Senate, contrary to a state constitutional provision requiring tax legislation to originate in the House.

The AFL-CIO is looking for support from state and local officials. It estimates they now have health insurance plans costing an average of $3,374 for each of 687,000 active and retired workers, for a total health tab of $2.3 billion annually. The argument is that broader coverage of private employees would cut the costs of uncompensated care now buried in the bills of those who are covered. However, to make the concept work, additional public financing would also be required by an extension of Medicaid and tax incentives for employers adopting health plans.

What happens if the Trust Fund isn't extended? Presumably individual New Jersey hospitals will create their own surcharges for uncompensated care, surcharges that would vary significantly from hospital to hospital. But Medicare and some health insurers wouldn't necessarily agree to pay the surcharges and private patients might well steer away from the hospitals providing the most charity care -- raising the problem of uneven incidence of such care that caused New Jersey and other states to adopt devices that spread uncompensated care costs evenly over all hospitals.

Health Spending: The department of Health and Human Services has concluded that spending on health care reached $604 billion in 1989, about $2,400 per capita. The overall spending increase was 11.1%, bringing health care expenditures to 11.6% of gross national product, a new high. The statistics suggest about half the increasing costs of direct patient care were associated with demographic change (9%) and general inflation (44%). The rest of the increase resulted from higher inflation in health costs than other costs (21%), and greater utilization of health care services (26%).

Health Care Costs By State: Estimates of the differing per capita health care costs (private and public) by state appear in Table 7.

Table 7: Estimated Per Capita Spending For Health Care, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Massachusetts	$3,031	18	Maryland	$2,436	34	Maine	$2,175
2	California	2,894	19	Florida	2,427	35	Oklahoma	2,139
3	New York	2,818		**United States**	**2,425**	36	West Virginia	2,088
4	Nevada	2,757	20	Colorado	2,415	37	Virginia	2,076
5	Rhode Island	2,707	21	Alaska	2,367	38	Georgia	2,072
6	Connecticut	2,699	22	Iowa	2,351	39	Montana	2,059
7	North Dakota	2,661	23	South Dakota	2,322	40	New Hampshire	1,981
8	Illinois	2,619	24	Oregon	2,312	41	Vermont	1,956
9	Michigan	2,569	25	Washington	2,311	42	Arkansas	1,944
10	Missouri	2,568	26	Alabama	2,286	43	Kentucky	1,875
11	Kansas	2,548	27	Delaware	2,268	44	North Carolina	1,833
12	Pennsylvania	2,536	28	Tennessee	2,262	45	New Mexico	1,792
13	Ohio	2,493	29	New Jersey	2,224	46	Utah	1,784
14	Minnesota	2,480	30	Arizona	2,211	47	Wyoming	1,756
15	Hawaii	2,469	31	Indiana	2,201	48	Mississippi	1,751
16	Nebraska	2,452	32	Texas	2,192	49	Idaho	1,726
17	Wisconsin	2,449	33	Louisiana	2,185	50	South Carolina	1,689

While there is a substantial amount of guesswork in both the national totals and the state-by-state breakdowns, the differences among the states have the characteristics that would be expected. Other things being equal, states with higher per capita incomes tend to have higher per capita spending on health care. Other things being equal, health care spending tends to be an increasing function of age. So the leading states tend to have disproportionately elderly populations, like North Dakota, or high per capita incomes, like Connecticut and New Jersey. The states with the lowest spending tend to have low per capita incomes and a relatively low median age.

Medicaid Costs: There are many different ways to view the Medicaid costs of individual states. Table 8 reflects several different concepts. The rankings and the first column show total (federal, state, and local) Medicaid spending per capita in FY 1989. That total spending is shown in column three (in billions) and per Medicaid recipient in column two. The final column shows the estimated FY 1990 share of total health care costs in the state paid by the state and local (but not federal) Medicaid spending. The states shown are the top ten in Medicaid spending per capita plus all other states where total Medicaid spending was a billion or more in FY 1989.

Table 8: Dimensions of Medicaid Spending, Selected Years And States

Rank	State	Per Capita ($)	Per Recipient ($)	Total ($ million)	Percent of State Health Spending
1	New York	$568	$4,522	$10.2	10.5%
2	Massachusetts	405	4,109	2.4	6.9
3	Rhode Island	375	3,634	0.4	6.4
4	Connecticut	317	4,501	1.0	5.8
5	Maine	304	3,030	0.4	4.8
6	North Dakota	270	3,832	0.2	5.0
7	Minnesota	254	3,426	1.1	6.1
8	New Jersey	248	3,602	1.9	6.0
9	Ohio	244	2,351	2.7	4.6
10	Louisiana	236	1,967	1.0	3.6
13	Wisconsin	230	2,784	1.1	4.4
	United States	**219**	**2,318**	**54.5**	**4.5**
15	Michigan	211	1,794	2.0	4.2
16	Indiana	207	3,703	1.2	3.9
17	Pennsylvania	204	2,233	2.4	4.1
25	Georgia	190	2,108	1.2	3.6
26	California	189	1,653	5.5	4.2
29	Illinois	180	2,106	2.1	4.0
30	North Carolina	177	2,390	1.2	3.1
39	Florida	151	2,184	1.9	2.8
45	Texas	131	1,878	2.2	3.1

State Responses To Cost Pressures: HealthWeek (12/17) interviewed some of the nation's leading health figures on the outlook for health policy in 1991. One of those interviewed was Ray Hanley -- the Arkansas Medicaid Director serving as chairman of the American Association of Medicaid Directors. He noted the pressures of lawsuits by health care providers over reimbursement rates, new federal mandates, and other factors increasing costs, and concluded:

> The prohibition against deficit spending in most states, coupled with the pressures already detailed, dictate hard choices if provider reimbursement is raised substantially to settle or avoid legal action.
>
> For example, optional programs must be curtailed or eliminated -- primarily in services for adults. In Arkansas, we recently eliminated our medically needy adult program. Now, providers receive no payment when serving these people. We also suspended coverage for several adult services, including dental and psychologist services.

In addition, states will be unable to fund optional Medicaid expansions, such as 185% poverty coverage for pregnant women.

Oregon's Health Plan: While Oregon's plan for dealing with Medicaid has attracted national attention, it is now several years behind its original schedule and no where near a stage that could be copied by other states.

The essence of the plan is to prioritize the health services offered under Medicaid, skipping some less significant expensive services for a few so that available dollars can provide more services for more people. The first step is developing a priority list. A draft released in May was withdrawn with a new list promised successively for the summer of 1990, the fall of 1990 and now March of 1991. Then the legislature must act to approve both the listing and an associated Medicaid budget. Then a waiver of Medicaid regulations must be obtained from the federal government, a process expected to start in July and end around the end of 1991. Neither legislative nor federal approval can be presumed.

FEDERAL IMPACTS ON STATES

Introduction: In releasing NCSL's survey of legislative leaders' priorities, NCSL President John Martin (Maine's Speaker) discussed what he called "a significant and growing concern to state legislative leaders" -- federal decisions affecting states. While recognizing the role of other factors contributing to state fiscal problems, he commented, "more and more legislative leaders are identifying the federal government as a major factor." Why: "As is clear from the last budget agreement, Washington's solution to its inability to deal with the federal deficit is to transfer the problem to state governments."

State officials see problems appearing in each session of Congress through the combined impacts of: (1) restrictions on the deductibility of state and local taxes, (2) limits on tax-exempt financing, (3) reductions in grant programs, and (4) unfunded mandates. The basic concern is that federal officials will respond to tight fiscal circumstances by cutting direct and indirect support of state finances and simultaneously respond to the need for action on domestic priorities by mandating state and local action without funding the mandates. Assessing the situation from a federal perspective suggests all these fears are based in reality.

Federal "Subsidy" Of State And Local Government: Much federal staff work views the federal government as aiding state and local governments in three ways: (1) the deductibility of certain state and local taxes (primarily real property and income) from income subject to federal tax, (2) the "subsidy" inherent in permitting issuance of tax-exempt bonds which, because interest isn't subject to federal tax, have lower interest costs than corporate bonds or even federal bonds, and (3) grants.

Many state and local officials reject this formulation -- arguing that deductibility and tax-exempt bond authority have their basis in conceptions of federalism and therefore aren't of the same character as decisions on budgeted grant programs.

But as they consider ways to reduce the federal deficit, the President and Members of Congress are constantly confronted with tables and option papers which treat tax-exempts, deductibility, and grants on an equal basis. Each of these "subsidies" has a cost, which is measured annually in the federal budget documents and various special reports such as those issued by the Congressional Budget Office. The cost of grants is a regular budget outlay. The costs of deductibility and tax-exempts are "tax expenditures."

Assessing Deductibility And Tax Exempts: The deductibility of state and local taxes and, even with restrictions, tax-exempt bond issuance authority involve considerably less federal control over how state and local officials use resources than grant programs, except general revenue sharing. From a perspective that the federal government ought to control carefully the priorities associated with use of its scarce resources applied by state and local officials, broad subsidies of tax-exempts, deductibility, and general revenue sharing are all to be avoided. This perspective constantly finds its way to the table in federal budget balancing discussions. For example, in a recent book (see below), Dennis Zimmerman (Congressional Research Service) concludes: "Tax-exempt bonds and state and local tax deductibility are, in effect, the equivalent of open-ended matching grants for the entire spectrum of state and local services." He notes that with tax-exempts, deductibility, and open-ended grants, "the federal government loses its ability to control its budget."

Limits On Deductibility: The history of federal income tax law over the last 20 years is one of a continuing reduction of the extent to which taxes paid to state and local governments are deductible from income subject to federal tax.

Past actions removed the deductibility of motor fuel and sales taxes. The 1990 legislation has a complex provision which reduces deductibility for taxpayers with incomes over $100,000. In its Federal Update (11/2), NCSL commented the provision "poses a major threat to state fiscal systems and is likely to be revisited as a source of increased federal revenues."

Tax-Exempt Bonds: State and local governments are now operating under substantial constraints on their ability to issue bonds with interest exempt from federal income taxes. The use of these bonds, particularly for financing activities in the private sector, have been under continuous attack in the Congress as: (1) distorting private sector incentives, (2) eroding the federal tax base, and (3) reducing the progressivity of the federal tax system by providing a haven for the rich to earn interest without paying taxes. As a result, complex regulations govern "arbitrage" (borrowing tax-exempt and lending taxable), there are restrictions on the form of bond issues (e.g., eliminating bearer bonds), and significant caps on the volume of certain issues.

Dennis Zimmerman (Congressional Research Service) traces two decades of history and examines the many policy issues involved in a new book, The Private Use of Tax Exempt Bonds (Urban Institute Press, 1991). Because of the possibility of abuse of unlimited authority to issue tax-exempts, Zimmerman believes there must be some limits set by the Congress, while leaving room for tax-exempt financing of public projects like schools and roads. Doing this hasn't been easy:

> To develop effective legislation has been and remains extraordinarily difficult. Each major piece of tax legislation since 1980 has changed the tax-exempt bond rules in an atmosphere of intense lobbying by representatives of state and local governments. Administrations have usually urged Congress to tighten the rules. Representatives of the investment bankers and bond counsel whose livelihoods are determined by the volume of issuance enter into the legislative fray in a predictable but understandable way. The compromises reached have accomplished some federal objectives, but at the expense of significantly complicating the legitimate fiscal activities of state and local governments. Beyond the frustration of coping with ever-changing rules, state and local officials express genuine philosophical concern about whether the new rules conform to their understanding of traditional concepts of American federalism.

Zimmerman's book is a definitive background piece which will likely become the standard source for both the history of the issue and the arguments in use on all sides. Zimmerman sees the logical result as elimination of tax-exempt financing for small-issue industrial development bonds, single-family housing, student loans, and more. Given the resulting restriction of purpose, he suggests there could be some relaxation of other controls. This issue arose in the 1990 deficit reduction legislation because provisions authorizing certain tax-exempt bonds were due to expire. In some of the compromise versions, they were not continued. But they were continued in the version that ultimately passed, but only for 15 months -- guaranteeing the issues will be back.

Grants: So long as there is a perceived federal deficit problem, there will be considerable pressure to reduce amounts provided to state and local governments as grants, particularly outside the grant entitlements like AFDC and Medicaid. The complex provisions of the new budget reduction legislation will force grant allocations into competition with spending pressures for direct federal domestic outlays. NCSL (Federal Update, 11/29) summarizes the provisions as follows:

> The impact of these spending limits will likely force federal aid programs for state and local governments to compete directly with other pressing budgetary priorities. More important, because the federal government will have less money to launch new domestic initiatives, states can expect a heavy reliance on unfunded federal mandates.

Mandates: Members of Congress continue to campaign on the basis of improvements they will help to produce in American society. They are unlikely to find that continuing national defense expenditures, the existing Social Security and other entitlement programs, and paying interest on the national debt will fulfill any aspirations they have for improvements in areas such as education, health, housing, pollution control, and transportation. With no fiscal room for new grant programs, this leaves unfunded mandates as the only road to apparent national progress through federal action.

This perspective on likely federal policy is widely shared among state officials. For example, NCSL's detailed assessment of the federal budget compromise (by Martha Fabricius and Christopher Zimmerman) commented that the agreement's requirements that grants compete for growth money with direct federal outlays mean "states can expect the decline of the last decade in the federal share of joint programs to continue." They continue, "Congress will apparently have relatively little room for new initiatives over the next five years. This makes it more likely than ever before that any new initiatives will rely heavily upon unfunded mandates imposed upon the states."

Will The Pressures Abate? There is widespread skepticism that the federal deficit-reduction agreement will produce deficits as low as the enacted targets. The comments in Business Week (11/5) are typical, except that they highlight the National Association of State Budget Officers rather than other forecasters. NASBO is quoted as using a projection of $250 billion for the deficit in FY 1995 -- about the current deficit and a far cry from the $63 billion in the law's projections. This would take the total federal debt to over $4.5 trillion by FY 1995. As debt rises, so does the interest bill. In FY 1992, interest alone will be nearly $1,000 per capita, putting greater pressure on federal officials to raise taxes or cut spending.

REVITALIZING THE ILLINOIS ECONOMY

Introduction: Illinois economic performance isn't anything to write home about. While national manufacturing employment remained about constant over two decades, the state lost about a quarter of its manufacturing jobs. If the state's growth had matched the national average in the 1970s and 1980s, there would be 1.5 million more people employed than now have jobs. Arguably, the state has been in an economic ice age -- ripe for the 355-page book with solutions, Coming Out Of The Ice: A Plan To Make The 1990s Illinois' Decade (Joseph and Diane Bast, eds., Heartland Institute, 634 S. Wabash Ave., Chicago, IL 60605).

The publication appears to be the most ambitious effort of the Heartland Institute. The Institute, organized as a not-for-profit corporation, is oriented toward dealing with state and local issues in the Midwest. It has previously published studies on such issues as the Midwestern business climate, subsidies of sports stadiums, privatization, tax abatements, Wisconsin's tax climate, and deregulation in transportation. The organization's substantial publications list and professionally published materials indicate that its combination of business and individual sponsors provide considerable support. Its Illinois publication is endorsed by the head of the Illinois Manufacturers' Association and several legislators. But the group certainly isn't "establishment." Its brochure advertising Coming Out Of The Ice features a picture of long-time Illinois Governor Thompson (R) with this quote: "I don't pay much attention to The Heartland Institute, and I don't think voters across Illinois will pay much attention to them either."

While the policy recommendations are for Illinois, their logic suggests they would be applicable to all states. Illinois doesn't have exceptional state policies. Its taxes are about average by all measures. So are its spending levels and patterns.

Taxes And Economic Growth: The book argues, "The most important single step Illinois can take to increase its economic growth rate is to cut state and local taxes." For the state, this implies letting the 1989 temporary tax increase expire. This is the same increase that was a major issue in the 1990 gubernatorial campaign which Governor-elect Edgar won despite (or because of) his endorsement of renewal. Without the surcharge, the flat rate income tax would be 2.5%, which Heartland says Illinois should drop to 1.5% while taking the corporate rate to 2.4%. In addition, the group wants "significant property tax relief, perhaps by requiring public referenda on any year-to-year increase in property taxes." To support the tax cut recommendations, the group relies on an extensive canvass of the literature on the relationship between taxes and economic growth and a small contribution of its own to this literature.

As often noted, there is room for argument over what can be concluded about the tie between taxes and growth. Coming Out Of The Ice will provide a convenient compilation for those seeking support for the argument that taxes make a major difference.

Providing Public Services: The lengthy discussion of providing public services is heavily oriented to privatization -- continued public responsibility for seeing that services are provided but looking to private contractors as providers of services.

In education, this means a heavy orientation toward choice plans, including a version of tuition tax credits that would work with rebates of school property taxes. The private sector is also seen as the salvation of transit systems and capable of contributing some new road construction. User fees placing more responsibility on heavy trucks are recommended. In corrections, Heartland recommends several policies designed to reduce prison populations: (1) community alternatives such as electronic monitoring, (2) cheaper facilities such as dormitory-type facilities for drunken drivers, (3) community service and other alternative sentences, (4) taking prison capacity into account in sentencing, and (5) possible decriminalization of drugs. In welfare, the group proposes emulating some of Wisconsin's requirements for eligibility and linking welfare eligibility to work. It also likes channeling more support for the poor through the tax system (e.g., greater deductions for dependents) and less through government welfare agencies.

While the book's recommendations on both taxes and spending are interesting, they aren't consistent. Even if Illinois adopted all the spending recommendations, it couldn't afford to adopt the tax recommendations.

Regulatory Reform: The regulatory reform recommendations generally call for reductions in state and local requirements -- occupational licensing laws, building codes, minimum wages, and bank regulation.

MISCELLANY

State Fiscal Conditions: Half the states are experiencing revenues that are 1% or more below their original revenue estimates according to a December assessment by the National Conference of State Legislatures. Only ten states reported their revenues were 1% or more above estimates. These were states favorably affected by higher oil prices -- Alaska, Louisiana, North Dakota, and Texas -- plus other states west of the Mississippi River -- Arkansas, Hawaii, Idaho, Nebraska, Utah, and Washington. Fifteen states reported revenues within one percent of the estimates on which their budgets were based.

The combination of revenue deficiencies and spending exceeding estimates produced potential shortfalls in 27 of the states surveyed by NCSL. In most of these states, the shortfall will be handled by combinations of spending cuts, revenue increases, deferrals of spending, acceleration of revenues, and intra-fund borrowings, so shortfalls won't appear in the year-end results. However, some states will report deficits. While 49 states have balanced budget requirements, some of those requirements are for enactment of a balanced budget but do not prohibit shortfalls in a budget viewed as balanced when enacted.

Most of the shortfalls indicated by the survey were less than 4%. While serious, such shortfalls are conceivably capable of being handled without tax increases or massive spending cuts. But some states reported much larger shortfalls -- Michigan (12.0%), Rhode Island (8.7%), Connecticut (7.7%), Missouri (7.5%), Vermont (7.4%), Florida (7.2%), New Hampshire (7.0%), Maine (6.2%), Georgia (4.4%), and Delaware (4.2%). These shortfalls not only present a serious FY 1991 problem, they are so large that they make it extremely unlikely that FY 1992 could be balanced without tax increases or truly major spending cuts.

The final version of the survey, The State Fiscal Outlook For 1991, was scheduled for release at the NCSL Fiscal Chairs seminar in early January. State officials have been revising their estimates frequently as new data becomes available on actual revenue collections and national economic statistics and forecasts become more dismal. So the individual state results cited above will be obsolete by the time readers have occasion to use them.

Legislative Priorities: NCSL has issued a survey of state legislative leaders, Top Priorities For State Legislatures In 1991. The first priority, state finances and taxes, is no surprise. Education placed second with the environment third. There are also many process issues on the legislative agenda including reapportionment, campaign finance, and ethics.

TECHNICAL NOTES

Welfare Reform: The state scores appear in Children 1990: A Report Card, Briefing Book, and Action Primer (Children's Defense Fund, 1990). State policy issues associated with children in special situations (e.g., homeless, born addicted to drugs) are the subject of the June issue of State Government News.

Corrections: The data on prisoners, probationers, and parolees are kept by the U.S. Department of Justice, Bureau of Justice Statistics. The state statistics include a small number of federal prisoners. Probation is generally an alternative to a prison sentence. Parole occurs after a prison sentence, by way of reduction of the time to be served in prison. The New York study comes from the Office of the State Comptroller (Alfred E. Smith State Office Building, Albany, NY 12236).

The alternatives to prison sentences, such as community corrections programs, are discussed in the lead article of **Reports**, Vol. 7, Issue 22 (November 1989).

School Finance Equalization: For a discussion of the complexities of school finance revision in New Jersey, see New Jersey Reporter (June/July). On the reasons why similar measures haven't passed in New York and the possibility of litigation there, see Empire State Report (August). The Texas debates resulted in two useful reports from the House Research Organization (P.O. Box 2910, Austin, TX 78769), An Introduction To School Finance and Wrap-Up Of The 1990 Special Sessions On Public Education. An 83-page report by the Tennessee Advisory Commission on Intergovernmental Relations (226 Capitol Blvd., Nashville, TN 37219) is informative at two levels. Fiscal Capacity Of Public School Systems offers technicians an excellent example of applying the concept of a representative tax system, pioneered by the U.S. Advisory Commission for states, to the local level. To non-technicians, it is illustrative of the complexities that can be involved in court consideration of school finance equalization decrees.

Health Care: The state-by-state costs of health care were calculated by Lewin/ICF for presentation in a report by Families USA Foundation (1334 G St., NW, Washington, DC 20005). The report, EMERGENCY! Rising Health Costs In America, was issued in October 1990. Statistical tables include projections of cost by state for the year 2000, an estimate of the uninsured population, the health care costs picked up on Table 7, and the components of health care costs including the Medicaid share which is included in Table 8. The other data in Table 8 are from the federal Health Care Financing Administration via the New York State Comptroller (A. E. Smith State Office Bldg., Albany, NY 12236) who used the data for all 50 states to further his argument that New York's nation-leading Medicaid costs should be reduced.

Federal Impacts: The concerns over federal mandates are reported almost constantly in articles like "Those Maddening Mandates," State Government News (12/90). NCSL and other state organizations are trying to make their monitoring of potential mandates more systematic as a way to prevent federal officials from imposing more of them. The "Mandate Monitor" is described in The Fiscal Letter (Nov./Dec. 1990).

The monitoring of mandates resulted in a count of "at least 20" additional mandates imposed on the states in the 101st Congress. This includes substantial mandating in the Clean Air legislation along with the many mandates in the budget-balancing legislation and other bills.

It is nearly impossible for any state to track costs associated with federal mandates because cost-driving events don't come labeled as mandates, even if that is their origin. They may appear as federal regulations. They may appear as state regulations or state laws without separate labels indicating they are responding to mandates rather than the best judgment of those adopting them. They may appear as court decisions, as consent decrees, or as agency policy adopted to avoid feared litigation.

An internal memorandum of Michigan's budget agency (Department of Management and Budget, P.O. Box 30026, Lansing, MI 48909, "The Judicial Impact On the Michigan Budget," 8/23/90) provides a seven page listing of litigation with budget impact. Some items (and fiscal impact if resolved unfavorably to state): hospital reimbursement under the federal Boren Amendment ($50 million), consent decrees for corrections ($17 million), mental health facilities layoff procedures ($20 million, one-time), mental hospitals consent decree ($11 million), adult foster care facilities reimbursement rates (unknown), certification of beds in private nursing homes (up to $100 million, one-time), and an old school desegregation case ($4 million). There is also a listing of national cases with implications for Michigan.

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The optimism that state governments alone offer the solutions to nearly every problem has been cooled by fiscal realities and the continuing federal mandates of state spending.

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January 1991 (Second of Two January Issues)

ECONOMIC DEVELOPMENT STRATEGIES

Introduction: The immediate attention of most state elected officials is now drawn to budget-balancing. This forces attention on unpopular choices -- cutting programs and raising taxes. But officials will be looking for more popular things to do, such as stimulating economic growth. At the same time, concerns of the unemployed and underemployed will become more pressing. Many of the unemployed can't easily be -- indeed don't want to be -- reached by traditional state programs. What they really want is a job, not welfare or job training or any other state program. Their need to earn income is shared by their state, as state economic growth provides the fiscal room to continue and enhance programs without tax increases.

If past patterns are any indication, concern will soon move to state policies to promote economic development. In this context, it is relevant to ask several questions. First, what strategies have proven popular among state officials? Second, what programs are being pursued now? And third, what is known about what strategies and programs have proven effective in the past?

Multiple Strategies: There is a considerable debate between "old" economic development strategy and "new" economic development strategy. For opponents, the old strategy is "smokestack chasing." For proponents, it is aggressive marketing of the state's assets and attempts to maintain a reasonable business climate. For opponents, the "new" strategy is an inherently futile, wasteful, and unfair attempt to "pick winners" among private firms and industries and a new way to rationalize spending on traditional government activity like education, public works ("infrastructure"), and even social welfare. For proponents, the new strategy targets state resources to the areas of a state's comparative advantage and invests state resources in what government does best, particularly education. These debates are more often found in academic and journalistic assessments of state policies than in actual state policy debate.

While a case can be made that some states are leaning toward one view more than another, practically every state pursues some elements associated with each of these strategies. The disputes about what best promotes development has encouraged states to cover all the bases.

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Indiana provides an example where a governor who was critical of past development efforts is opting to pursue a strategy that resembles them closely, while Arizona illustrates the pressure to match other state incentive programs. Colorado's recently announced strategy shows the tendency for individual states to adopt all available strategies, rather than picking among them.

Industrial Recruiting, Indiana Style: This fall, Governor Bayh, the Indiana Chamber of Commerce, and CEO's of several Indiana utilities announced a new public-private partnership to recruit business to Indiana. The state's spending for marketing, advertising, and recruiting will be doubled. Top executives will be involved in recruitment. There will be more training of state and local development officials. And, an effort will be made to target particular industries. The governor commented, "The 1990s will prove to be even more competitive than the 1980s proved to be." So, he concluded, "We need to be much more aggressive." A consultant to the state told the press that there was increasing interest by business firms in incentives provided by state and local government.

Considering The Options, Arizona: In October, the 57th "Arizona Town Hall" assembled many of the state's notables to discuss economic development. The conferees recommended a stronger role (and bigger budget) for the state's economic development agency plus one-stop shopping for state permits. The group's report stresses a private-public partnership for development. The conferees argued over the value of providing incentives for individual firms. The group's written report commented, "So long as other states offer tax incentives for economic development, it appears that Arizona may have to do the same." The group's definition of when incentives would be appropriate would probably command acceptance anywhere, but offers considerable room for interpretation:

> Before any incentive is implemented, there should be a careful weighing of its costs and benefits. The costs and returns from the incentive must be quantified to assure that there is a positive economic return and benefit to the state and community as a whole. In short, only those incentives should be implemented that represent sound investments.

The Third Wave: Yet another approach, a "third wave," is offered to state policymakers by Doug Ross and Robert Friedman in The Entrepreneurial Economy Review. The authors suggest several deficiencies with second wave programs: (1) insufficient scale of activities, (2) fragmented service, (3) lack of accountability, and (4) little link between economic and social concerns. The third wave abandons the approach that government agencies should do everything in favor of more favorable organizational approaches. The examples of activities involve significant private sector investment, "demand-driven" activities, and competition. The vanguards are offered as:

(1) the Michigan Strategic Fund, which tries to encourage formation of private financial institutions, (2) Minnesota's education choice program, and (3) the North Carolina Rural Economic Development Center, which emphasizes technical assistance and training rather than grants for rural areas.

Development Strategy In Action, Colorado: Colorado was one of the Western states suffering serious economic problems in the mid-1980s as a result of a decline in resource prices and other factors. The state's response has included an extensive economic development effort, including development planning that culminated with the publication of Colorado's Five Year Economic Development Strategic Plan last summer. The plan reflects a private-public partnership, including many steps taken by legislation as well as by action in the executive branch. It doesn't leave many stones unturned. The report of nearly 200 pages discusses 36 specific initiatives in education, 42 in jobs, 25 for rural communities, 22 related to the environment, and 13 for infrastructure.

Colorado hasn't rejected head-to-head competition for location of facilities. The executive summary boasts:

> ... the state has been successful in winning the bid for the US WEST Research Center, Cable Labs, Wal-Mart's new distribution center, the new Nordstrom's department store and credit card operation, and expanded offices for Merrill Lynch and American Express. We have not won all the bids that Colorado has competed for, but we have accomplished our goal of being viewed as a contender for major business enterprises.

Colorado hasn't been reluctant to enter national competitions for facility locations including the supercollider, Sears, Sematec, and the United Airlines and Smithsonian facilities discussed below.

Recruiting and other activities haven't been neglected either. The economic development functions have been reorganized, the governor is an active business recruiter, tourist board activities have been expanded, there are new state offices in Japan and Taiwan, and a seal of quality is now offered for state apple growers. There have also been tax changes, including revising truck taxes, avoiding the move of many states to telecommunications taxes, reducing the severance tax on coal and molybdenum, creating enterprise zones, and adding a tax credit for new coal sales. The state has also sought to reduce regulations affecting business, such as an effort to streamline mining regulation. Reducing Workers' Compensation costs is also a "key initiative."

While Colorado exhibits a substantial commitment to "first wave" economic development strategies, there is also a commitment to what might be called "second wave" and "third wave" strategies. The Colorado plan doesn't make a distinction in terms of waves. Instead, it

recognizes: (1) business development programs, (2) community development programs, and (3) "foundation" programs such as education, environmental protection, and infrastructure. The plan sees all three as "intertwined."

Colorado also maintains many programs to assist business including financing, technology transfer, research and development, job training, small business assistance, and more. Besides the state's marketing, business climate, and business assistance programs, the plan has a full platter of policies for dealing with elementary and secondary education, higher education, job training, pollution control, recreation, water supply, transit, telecommunications, and air transportation, including the new Denver airport.

The Outlook: During the late 1980s, practically every state was experiencing enough prosperity so that: (1) current state services could be continued without tax increases and (2) the overwhelming majority of voters had jobs or had reasonable prospects of finding ones in their chosen fields. These two conditions were considerably different from those experienced in the 1980-81 and 1982-83 recessionary periods. With a lag, states tended to respond to the earlier recessionary conditions with new efforts to do something about job creation, above and beyond their then traditional economic development policies. It would not be surprising to see a revival of interest in economic development strategies as the economic pressures on both state citizens and state budgets become more widespread.

ECONOMIC DEVELOPMENT PROGRAMS

Counting Development Programs: Keeping track of the separate economic development programs of the 50 states has become a formidable task. Conway Data tries every year with a series of matrices of states and programs in Site Selection. The latest (October) lists 18 different kinds of financial assistance for industry, 15 forms of tax incentives, 18 kinds of special services for industrial development such as free land and export promotion programs, and ten state incentives for pollution control. With 61 programs and 50 states, the tables have over 3,000 entries, not including extensive footnotes.

Even such a comprehensive inventory cannot capture the richness of industrial development incentives. It excludes the many local programs. It doesn't include special programs in enterprise zones (see below). It indicates whether individual states have individual programs, but doesn't provide details on the programs. They vary considerably in eligibility requirements, funds available, and their perceived usefulness to those locating new facilities.

Development Agencies And Marketing Efforts: There is no precise count of the many state and local agencies devoted to promoting economic development, in part because many of them have multiple

purposes as is the case with a local chamber of commerce or state development agency. In one of the latest texts on development (Economic Development Programs For Cities, Counties And Towns, Praeger, 1990), John Levy (Virginia Polytechnic) makes an educated guess. He counts 15,000 to 18,000 organizations devoted to promotion of local economic growth. He calculates that this high number would imply operating costs of these agencies to be in the neighborhood of $4 billion a year. To this figure would be added state outlays for all economic development purposes, local outlays for industrial parks and other projects, federal "tax expenditures" for industrial development bonds, and federal outlays for economic development programs.

Enterprise Zones: Some state governments are continuing to emphasize enterprise zones, even though the original impetus for state action was anticipating a federal program thought likely to pass in the early 1980s that never has been implemented. The states typically designate zones based on criteria of economic hardship such as unemployment and/or low income. Companies that expand employment in a zone are given tax incentives and/or capital financing. In a few states, public infrastructure investments are also targeted for the zones. Conway's inventory (see above) has a supplement detailing 15 different policies states pursue for their enterprise zones. Most of the zone incentives are forms of tax incentives. A rough idea of how intensively the states with zone programs have been supporting them is indicated by Table 1, which shows the number of the possible 15 in effect in each state that uses zones.

Table 1: Number of Enterprise Zone Incentives, 1990

State	Incentives	State	Incentives	State	Incentives
California	11	Missouri	6	Michigan	3
Indiana	9	Vermont	5	Mississippi	3
Illinois	8	Alabama	4	New York	3
Kansas	8	Delaware	4	Ohio	3
Maryland	8	Nevada	4	Tennessee	3
Connecticut	7	Texas	4	Virginia	3
Florida	7	Utah	4	West Virginia	2
Louisiana	7	Arkansas	3	Arizona	1
Minnesota	7	Colorado	3	Georgia	1
New Jersey	7	Kentucky	3	Hawaii	1
Wisconsin	7	Maine	3		

Enterprise zones continue to get mixed reviews among policy analysts (see Technical Notes). The states are making modifications in zone programs as they gain experience with them. For example, this year Tennessee converted from tax credits to reimbursements that are subject to the availability of appropriations.

High Tech Incentives: The number of states with special incentives to promote high technology business has been growing rapidly. A spring 1990 survey reviewed the states with each of nine incentives. Every state reported that it made university R&D facilities available to industry. Entrepreneurial assistance was provided to high-tech companies by all but one state, while technology transfer centers or other activities were provided by all but two states. State science or technological advisory councils exist in all but nine states. There is also substantial grant and tax exemption money available in the form of tax exemptions for R&D (30 states), venture capital (31 states), R&D grants (37 states), incubators (33), and state funds for research parks (24). All told the survey listed nine polices a state could follow. Most of the larger states were pursuing all nine approaches. The other states appear on Table 2.

Table 2: Number Of State High Tech Initiatives, Nine Possible
NOTE: States Not Shown Have All Nine Initiatives

State	Number	State	Number	State	Number
Alabama	8	South Dakota	7	Idaho	5
Colorado	8	Virginia	7	Kentucky	5
Maine	8	Arkansas	6	Massachusetts	5
Montana	8	Delaware	6	Texas	5
Ohio	8	Hawaii	6	Washington	5
Oklahoma	8	Minnesota	6	West Virginia	5
Oregon	8	Mississippi	6	Arizona	4
Utah	8	Nebraska	6	New Hampshire	4
California	7	New Mexico	6	North Dakota	4
Georgia	7	Rhode Island	6	Tennessee	4
Louisiana	7	Vermont	6	Nevada	3
New Jersey	7	Wyoming	6	Alaska	2

Border Wars And Commodity Exchanges: The Wall Street Journal (10/30) called the offers "lucrative even by the standards of recent contests." The prize was the location decision of a group of commodity trading exchanges now located in New York City, with as many as 12,000 jobs at stake. The winner, New York. The price was not disclosed, but the New York Times reported "a construction grant of $82 million, tax and rent subsidies worth $56 million and energy savings of nearly $7 million." One source reported the New Jersey offer as a $100 million capital grant, but New Jersey officials didn't publicize their offer. That state's Commerce Commissioner said after the decision was announced, "We knew all along that the exchanges were really using New Jersey as leverage to get a better deal out of New York."

New Jersey claims continued success in drawing firms from New York. The New Jersey development agency counts 51 announced relocations from New York in 1990, with each one representing an average of 140 jobs. The 1990 count is up from the levels of 1988 and

1989, but down from higher levels claimed in 1986 and 1987. The major relocation decisions in 1990 involved back office operations of financial firms, distribution centers for manufacturers, and relocations of air traffic activities to Newark Airport.

New Jersey And Its Neighbors: The New Jersey tax package which passed last year has stimulated considerable debate about the impact on the state's business climate raising issues of importance in all states.

One school of thought suggests that to the extent business location decisions are sensitive to state and local taxes, they are sensitive to taxes only on the firm. By this criterion, the New Jersey package was a winner. It raised $2.6 billion without touching business -- with the primary increases in the individual income tax and the sales tax. Part of the anticipated effect is lower property taxes providing a significant benefit for businesses, particularly those located in the areas where relief is expected to be greatest such as Newark. In September, the New Jersey Commerce Commissioner suggested the package was helping the state, "If you're a businessman, you look at the bottom line and the bottom line is we didn't increase the corporate business tax in New Jersey."

The other perspective looks at the total tax environment, including taxes on individuals as well as firms. One version looks specifically at the taxes to be paid by the corporate executives who make location decisions. By that criterion, the New Jersey package is much less favorable. It concentrated its income tax increases on high income households, which will also be affected by the sales tax increase. In addition, the redistribution of school aid may cause higher property taxes in the more affluent suburban areas. Although it didn't deal directly with development prospects, a survey by the New Jersey Business and Industry Association shows the governor as having low popularity.

The Commerce Commissioner also suggested the New Jersey package would look better in 1991 than it did in 1990. He pointed out New York and Pennsylvania were waiting until the November 1990 elections to deal with their serious fiscal problems, but predicted when they did, "New Jersey is going to smell like a rose."

Economic Competition Continues: With the economy in the doldrums, there aren't many major economic development plums for states to fight over. But there appears to be hot competition for those available.

The Smithsonian Institution has found that its Air and Space Museum in the District of Columbia won't accommodate the increasing number of aircraft and space vehicles it is acquiring and believes the public wants to see. So it is planning an "annex." The annex, estimated to cost up to $300 million, would hold such attractions as the space shuttle Enterprise and the bomber that dropped the first atomic bomb. The initial competition for the facility was confined to the Washington, DC area. Virginia officials pushed a site at Dulles Airport while Maryland officials urged using the Baltimore airport, which is about as close to Washington as Dulles. The competitors offered free land, tax-exempt bond financing, and other incentives. In early 1990, Smithsonian officials picked Virginia over Maryland and over a proposal from the Denver area that apparently was taken less seriously. The Denver group wants to use Stapleton Airport, which will become surplus when the city's new airport is built. Now, the issue has apparently been reopened because of interest in the Denver site by a key member of the House Appropriations Committee. So Smithsonian officials are taking another look at Denver.

There is much unheralded competition for the location of offices of regional and national organizations. One recent one involved the Southeastern (collegiate athletic) Conference. It will stay in Birmingham for 15 years, shunning Atlanta and other cities that vied for the honor. Its rent, according to press reports, will be $1 a year for a building costing $3 million. The financing will come through the city and its civic center.

Many states are competing for a planned United Airlines maintenance facility that would open in 1993 and eventually have up to 7,000 employees. The leaders are said to be Kentucky (two sites), Oklahoma (also two), and Denver. Other states have expressed an interest, with Virginia's legislature likely to consider legislation this year that would increase its authority to offer incentives.

EVALUATIONS OF DEVELOPMENT PROGRAMS

Introduction: As more state resources go into development programs and more time passes in which past investments can go sour, the criticisms of development efforts have escalated. There has always been academic criticism of development incentives as a "zero sum" game and as giving business interests too much control over state policy. Without assurance that other states would act on the advice, this criticism hasn't much affected state policy. The problem is analogous to someone telling people that trying to get to the head of a line won't improve anyone's position, on average. Of more immediate interest are the criticisms that have developed in campaigns for state office and the evaluations that suggest states might improve their development success by altering the form of their development investments.

Candidates Critical Of Development Efforts: A significant number of candidates have been critical of some of the major state economic development efforts, particularly the large and well-publicized deals for major new plants and other facilities. Neil Hartigan (D, not elected) denounced the Diamond-Star and Sears deals in Illinois. Illinois new Governor Edgar was less critical of those deals, but said they would be less likely in his administration. He urged more investment in worker education and training, rather than in business firms. Governor Joan Finney (D) said in her campaign that she wanted to dismantle several Kansas programs created under the economic initiative fund (with funds from gambling, including the lottery) and consider cutting the Department of Commerce budget. She suggested that a better use of the funds would be in the "Margin of Excellence" program at state universities.

During the Minnesota campaign, then Governor Perpich (D) was consistently criticized on economic development issues. He was closely identified with the Greater Minnesota Corporation which his successful opponent indicated he would modify. There was also criticism of several development investments in Perpich's hometown, including a chopstick factory that closed and a biomedical company accused of fraud in obtaining and using the state subsidy. The new governor, Arne Carlson, has indicated support for the Corporation, but not necessarily its current level of funding. Half of the proceeds of the lottery were originally earmarked for the Corporation, but that has been reduced to 25%.

White Elephants: As time passes, more and more investments of state and local development money prove, in retrospect, to have been mistakes. The results are, at a minimum, politically embarrassing. But in the broad criteria of effectiveness, less than 100% success is not necessarily an indictment of the programs, but it's not an endorsement either. Quantified assessments of state and local investments aren't easy to find.

Some examples of the failures: The Wall Street Journal (11/21) described problems of overconstruction in hotels. The problems, which are likely to become more serious in recession, affect private investments, local use of Community Development Block Grant funds, and local money. In "Iowa Picky About Luring Businesses," the Des Moines Register (7/6) described the state's turning away from meatpacking and telemarketing as a result of getting more choosy about where to put development money. Last summer, North Dakota closed its Japanese trade office and ended its effort to promote an export trading company. Problem: no interest from the Japanese. The states that invested heavily to get the Navy's home port designations are now worrying that their investments may produce white elephants. With threats to the fleet appearing somewhat diminished, the Navy is less interested in decentralizing its fleet to new home ports like Everett (WA), Ingleside (TX), Mobile (AL), Pascagoula (MS), Pensacola (FL), and Staten Island (NY). Wyoming officials have encountered heavy opposition in funding their

economic development loan program because one of the early deals was a $1.25 million loan to a company that folded. The state's loans now involve private participation.

There are many examples of failures of horse and dog tracks, though most involve loss of private capital and only public image because the investments were associated with policy changes, like lowering taxes and providing racing days, believed likely to make the track investments feasible. But the investment by Polk County (Iowa) supervisors in a track was viewed as costing several supervisors their jobs in the June primary.

West Virginia's Supercredit: Perhaps the largest single failure of a state development policy is reflected in the fate of the "supercredit" in West Virginia. In 1985, faced with a declining state economy and elected officials intent on doing something about it, West Virginia built on the legislation in other states that provided tax credits for job expansion. But instead of following the pattern of the other laws by providing $500-1,000 for an additional job (sometimes with a requirement that a low-income person get the new job) for a limited number of years with restrictions on the credit not wiping out tax liability, West Virginia's approach was much more expansive. The cost of the credit grew from several million in 1986 to nearly $60 million on 1989 corporate tax returns. Furthermore, coal companies got about 90% of the benefit, even though it had been originally intended for manufacturers, such as GM's Saturn plant. According to one revenue agency study, 20% of the coal mining in West Virginia was occurring without tax liability.

The fundamental problems were twofold -- one intentional and one inadvertent. Both illustrate the problem of the credit approach. The intentional problem was that West Virginia decided on the ultimate in tax relief to encourage business. For job expansion, it basically forgave any liability for any state tax, not just the corporate income tax. The unintentional problem was that the law defined an enterprise as the target when it created jobs, whether or not the jobs replaced other jobs. Coal mining companies were able to eliminate production by one company and replace it with another -- thereby creating eligibility for the second company even though production wasn't expanded.

In 1990, the state reversed its course in part by establishing a "minimum severance tax" on coal. This provided some tax liability even for the companies that avoided old severance tax payments because of the supercredit.

Voters Reject Development Efforts: While voters have approved many development proposals that have appeared on state and local ballots, there are also some significant setbacks. Two examples illustrate some of the citizen concerns.

Louisiana's constitution covers considerable subject matter that is covered by legislation, not constitutional language, in other states. As a result, voters often face long lists of proposed amendments as they did in October when 15 were on the ballot. Of these, 14 passed including budget reform, changing the timing of the legislative session, revising Workers Compensation rules, and permitting tax exemptions for wholesale inventories, historical property, and housing for the homeless. The one which failed would have allowed local governments to donate or loan public money to private businesses to encourage them to move in or expand.

In a July special election, Hoboken (NJ) voters rejected an extensive port development plan previously approved by officials of the Port Authority of New York and New Jersey and city officials. The city will apparently have to pay back a portion of the funds already received.

Infrastructure And Economic Development: In the past several years, there has been considerable interest, particularly by those concerned with highway investments, in academic research appearing to indicate that economic growth is enhanced by investments in public capital (infrastructure). An extensive analysis of this theory appears in an article by Alicia Munnell in the New England Economic Review (Sept./Oct., 1990). Her detailed assessment of state-by-state information on public capital and other factors influencing development concludes that public capital does make a difference in encouraging economic growth. The capital investment that seems to matter is in highways, water, and sewage treatment facilities, not necessarily public buildings or schools. However, she also assessed the impact of overall tax levels, finding that higher taxes had a negative impact on development. The practical conclusion appears to be that a significant advantage will accrue to any state that can find ways to invest in infrastructure without raising taxes.

Assessing Development Programs: The state of the art in assessing the value of state economic development spending is not advanced. As Harry Hatry and his colleagues at the Urban Institute recently put it:

> State and local economic development program managers need to be able to identify the strengths and weaknesses of individual economic development programs as a first step to improving program quality. But assessment of economic outcomes is not a simple task, given the complexity of the economic environment and the lack both of generally accepted performance monitoring procedures and of generally accepted outcome measures.
>
> Many states have experimented in a limited fashion with performance monitoring. Efforts include ad hoc projections of future employment made by businesses

receiving state assistance, accounts of program results and service quality obtained through surveys of clients, and informal, anecdotal information. Such efforts have usually been sporadic, insufficiently comprehensive, unsystematic, or unreliable.

The absence of an agreed way to assess development programs made the debate in the 1990 gubernatorial races less than economically sophisticated. Repeating the logic by which Governor Dukakis obtained credit for the "Massachusetts Miracle," incumbents in states with job gains claimed them as evidence of success of their policies. Using the same logic, opponents stressed job losses. If there weren't job losses overall, they stressed job losses in particular sectors like manufacturing. There were many anecdotal claims and counterclaims based on decisions by firms to locate or expand in a state and, for opponents, decisions to leave for another state.

REASSESSING THE STATE ROLE

The Impotence Of State And Local Government: It may be inevitable that supposedly informed opinion operates in cycles, exaggerating both the good news and the bad news. Inevitable or not, there are signs that this may be happening with the role and possible impacts of state and local government -- oscillating from being the perfect governments to do everything in the late 1980s to largely incapable entities in the 1990s facing responsibilities overwhelming their resources and competence.

The Perfect Governments: The theme of state and local governments as the perfect governments gained considerable support in the 1980s. The theme fit perfectly with the desire of the Reagan Administration to have more decisions made closer to the people and to minimize the federal financial commitment to many domestic programs. It also fit nicely with federal financial circumstances which, after the 1980 tax cut, left a substantial federal deficit as long as major defense spending was continued and the Social Security and related Medicare program weren't cut. The theme suited most state officials, though many local officials were reluctant to see a shrinking federal role.

Problems With The Perfect Governments: There were two major reservations with this image of state and local government, especially state government, as the source of solution to the nation's problems. The first and most significant was that there was no solid indication that state officials would, in an interstate competitive environment, undertake individual state solutions to national problems such as health care. The second was that vast differences in tax base among the states made it inconceivable that states could adopt identical or even closely similar efforts in fields such as education for the disadvantaged. Levels of service that some states could afford others

could not without tax levels so far above those of other states as to constitute unreasonable burdens on citizens and threats to economic development.

Helpless States: While these problems have been in existence through the 1980s, they become more apparent in recession, when state budgets appear tighter than they did in the late 1980s. One journalistic reaction is the special report on "States in Distress" that covered two entire pages of the New York Times (12/30) plus a front page story, "80's Leave States And Cities In Need." The basic theme is that the pressures to spend are "enormous," that federal aid defrays a smaller share of state and local costs, and that, "The public is increasingly resistant to new or higher taxes, partly because they believe government is not wisely spending the money."

The article spelled out the scenario for problems at the state level. On the spending side, the emphasis was primarily on prisons and Medicaid, quoting the executive director of the National Governors' Association referring to Medicaid as "the Pac-Man of state government, eating up every dollar." On the revenue side, the article reflected Steven Gold's oft-stated view that economic growth (and thus state revenue growth) would be slower in the 1990s than in the 1980s. It quotes Gold as saying that states do have the option of raising taxes, but at the price of a possible voter reaction in 1992.

A somewhat similar theme is offered by columnist David Broder ("Is This The Year The States Finally Get The Hill's Attention?" Washington Post, 1/6). He cites three facts indicating state problems: (1) the tight budget situation, (2) federal mandates that have "been devastating to state budgets," and (3) a 96% success rate for Members of Congress seeking reelection but losses by six of 23 incumbent governors and changes in party control in 14 of 36 gubernatorial races. He then cites a fourth fact, redistricting of Congressional seats, and suggests state legislators may push for limits on mandates using their redistricting power as a lever. Legislators, he asserts, "will say that they are sick and tired of watching their Washington counterparts take credit for passing all these wonderful-sounding programs and then handing them most of the bills."

The problems of states were emphasized in a National Governors' Association release (1/2) reporting that many states were experiencing revenue shortfalls. The release noted slow revenue growth and rising spending. It continued:

> At the same time, states are feeling increasing pressure to use more of their own limited resources to provide for an expanding array of vital needs -- including health care and safety net programs whose inflationary costs have increased more quickly than state revenue growth, highways and bridges that have to be able to handle increasing traffic, adequate space for skyrocketing prison

> populations, and the education tomorrow's workforce will need to excel in an increasingly competitive economy.

A similar theme appeared from the Federal Reserve (in its Bulletin for December):

> The fiscal position of state and local governments has deteriorated markedly during the past several years, with many governments confronting potential shortfalls in their operating accounts... The last half of the 1980s has seen the financial resources of the states pressured by several concerns: the quality of education and rising school enrollment, the deterioration of the public infrastructure, and mandates to improve the health care of the needy and to upgrade correctional facilities. Over the same period revenue sources have dwindled.

Special Problems Of Cities: The Times assessment is most downbeat on the prospects of major cities, which are described as affected by cuts in federal and state aid, state restrictions on taxing authority, and an increasing concentration of problems in central cities. However, most cities will weather recession considerably better than states. Their revenues, based on user charges for local services and property taxes, are more recession-resistant. Their spending, which for most cities in the U.S. doesn't include welfare or indigent health care, excludes the categories most escalated by economic downturns.

The exceptions are cities which: (1) have county-like functions of welfare and health care, (2) rely significantly on sales and/or income taxes, and (3) are located in the Northeast. Philadelphia has a shortfall of 10% or more of its budget. Its cash crisis is so severe that the mayor has consented to the establishment of a state financial control board. New York has a deficit of as large as $800 million, depending on who does the estimate. The District of Columbia is short some $300 million. It is looking for $100 million more from the federal government as well as layoffs and other austerity measures.

POPULATION STATISTICS

The Census Bureau released its count of 1990 population by state in late December. The results are shown on Table 3.

Table 3: Population Estimates (000) By State, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	California	29,839	18	Washington	4,888	35	Utah	1,728
2	New York	18,045	19	Maryland	4,799	36	Nebraska	1,585
3	Texas	17,060	20	Minnesota	4,387	37	New Mexico	1,522
4	Florida	13,003	21	Louisiana	4,238	38	Maine	1,233
5	Pennsylvania	11,925	22	Alabama	4,063	39	Nevada	1,206
6	Illinois	11,467	23	Kentucky	3,699	40	Hawaii	1,115
7	Ohio	10,887	24	Arizona	3,678	41	New Hampshire	1,114
8	Michigan	9,329	25	South Carolina	3,506	42	Idaho	1,012
9	New Jersey	7,749	26	Colorado	3,308	43	Rhode Island	1,006
10	North Carolina	6,658	27	Connecticut	3,296	44	Montana	804
11	Georgia	6,508	28	Oklahoma	3,158	45	South Dakota	700
12	Virginia	6,217	29	Oregon	2,854	46	Delaware	669
13	Massachusetts	6,029	30	Iowa	2,787	47	North Dakota	641
14	Indiana	5,564	31	Mississippi	2,586	48	Vermont	565
15	Missouri	5,138	32	Kansas	2,486	49	Alaska	552
16	Wisconsin	4,907	33	Arkansas	2,362	50	Wyoming	456
17	Tennessee	4,897	34	West Virginia	1,802			

The population of the U.S. is highly concentrated in a few states. Three states -- California, New York, and Texas -- account for 26% of the population. The nine largest states account for 52%. The top twenty account for 76%, and the largest 30 for about 90%.

There are some significant changes in the rankings of the states from the rankings in 1980. Florida moved to fourth from seventh -- knocking Pennsylvania, Illinois, and Ohio down a rank to make room for the Sunshine State. Georgia moved from 13th to eleventh and Virginia from 14th to twelfth, kicking Massachusetts and Indiana down. At the bottom, Alaska moved up a notch to 49th, making Wyoming the least populated state.

Changes In Population: The Census Bureau understandably emphasized population change from 1980 to 1990, the two points anchored by an actual count of the population. The changes are shown on Table 4.

Table 4: Percent Change In Population, 1980-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	50.8%	18	South Carolina	12.3%	34	Arkansas	3.3%
2	Alaska	37.3	19	Vermont	10.6	35	New York	2.8
3	Arizona	35.3		**United States**	**10.2**	36	Mississippi	2.6
4	Florida	33.4	20	Maine	9.6	37	Montana	2.1
5	California	26.1	21	Oregon	8.4	38	Indiana	1.4
6	New Hampshire	21.0	22	Minnesota	7.6	39	South Dakota	1.3
7	Texas	19.9	23	Idaho	7.2	40	Kentucky	1.0
8	Georgia	19.1	24	Tennessee	6.7	41	Nebraska	0.9
9	Washington	18.3	25	Rhode Island	6.2	42	Ohio	0.8
10	Utah	18.3	26	Connecticut	6.0	43	Louisiana	0.8
11	New Mexico	16.8	27	New Jersey	5.2	44	Michigan	0.7
12	Virginia	16.3	28	Kansas	5.1	45	Pennsylvania	0.5
13	Hawaii	15.6	29	Massachusetts	5.1	46	Illinois	0.4
14	Colorado	14.5	30	Missouri	4.5	47	North Dakota	-1.8
15	Maryland	13.8	31	Oklahoma	4.4	48	Wyoming	-3.0
16	North Carolina	13.2	32	Wisconsin	4.3	49	Iowa	-4.3
17	Delaware	12.6	33	Alabama	4.3	50	West Virginia	-7.6

There are no surprises on the list, which reflects reasonably closely the year-by-year estimates made during the 1980s by the Census Bureau. The Census Bureau was required to report the population figures by the end of 1990, but can make adjustments between now and July 15. Officials of larger eastern cities and some states (e.g., New York) are arguing that there is a systematic undercount disproportionately affecting minorities in central cities. If the current count stands, California will gain seven Congressional seats, Florida will gain four, and Texas will gain three, with no other state gaining more than one. The big loser would be New York, which would lose three seats, followed by several Midwestern states losing two seats each.

STATE FINANCIAL DETERIORATION

Introduction: New York officials set the tone for an austere year by their inaugural ceremonies. Four years ago, Governor Cuomo's ceremony drew some 5,000 people and featured symphony music and a 19-gun salute. This year, to save money and symbolize austerity, the governor and lieutenant governor were sworn in at a simple ceremony in the chambers of the state supreme court, with an audience of under 100. Not to be underspent, the attorney general and comptroller skipped any ceremony and will file written oaths of office. In his brief remarks, the governor said, "The months immediately ahead of us are going to be perhaps more difficult than any since the Great Depression."

Budget Shortfalls: Most governors, particularly the 19 new ones, hadn't decided on budget recommendations by early January, but their budget officers had developed appraisals of their current fiscal situations. According to a survey released by the National Association of State Budget Officers in January, the nationwide shortfall in the current year (FY 1991) is $9.6 billion or 3.2% of planned spending. Most states reported some shortfall. Table 5 includes all the states that did.

Table 5: Reported FY 1991 Shortfall As Percent of Spending
NOTE: States not shown did not report having a shortfall.

More Than 5%	3.1% To 5%	3% Or Less
California	Arizona	Alabama
Connecticut	Georgia	Colorado
Maine	North Carolina	Delaware
Maryland	Tennessee	Florida
Michigan		Indiana
Mississippi		Iowa
New Hampshire		Massachusetts
New Jersey		Minnesota
Pennsylvania		Missouri
Rhode Island		New York
Vermont		Ohio
Virginia		South Carolina

These reported shortfalls show considerable correlation with the latest state-by-state economic data reported below. There is also a strong correlation between the states with the shortfalls of over 5% and the TaxWatch list reported by State Budget and Tax News in October. There are quite a few cases in which shortfalls were minimized or denied by incumbent governors running for reelection. Particularly obvious are Maine and Pennsylvania where shortfalls of 5% of the budget would appear to have developed in the two months between early November and early January.

Employment Change: The latest data on employment changes by state appear in Table 6. Reversing a trend of the late 1980s, when growth of 2% or more was common, growth in the last year for which data are available was 1% -- about identical to the rate of population growth. Nine states show declines, with the six states in New England turning in the worst performance. Also notable is the relatively poor performance of the Southeastern states, except South Carolina where a hurricane affected last year's job levels and reconstruction has helped employment this year.

The data provide a reasonable proxy for the fiscal conditions being experienced by many of the states. Except Florida, the states in the top 20 are in reasonably good condition. While states like Indiana are reporting shortfalls and there are problems in balancing the continuation budget in Texas, the problems are not of the magnitude of those experienced by the states with little or no employment growth.

Table 6: Percentage Change In Employment, October 1989-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	6.6%	18	Kansas	1.7%	34	Mississippi	0.7%
2	Utah	4.3	19	Minnesota	1.7	35	West Virginia	0.7
3	Washington	3.7	20	Kentucky	1.7	36	New Mexico	0.5
4	South Carolina	3.6	21	California	1.6	37	Missouri	0.4
5	Idaho	3.5	22	Iowa	1.5	38	Illinois	0.3
6	Florida	3.0	23	Wisconsin	1.5	39	Tennessee	0.2
7	Arizona	2.9	24	South Dakota	1.4	40	North Carolina	0.1
8	Nebraska	2.7	25	Louisiana	1.4	41	Pennsylvania	0.1
9	Oregon	2.6	26	Wyoming	1.4	42	New York	-0.2
10	Arkansas	2.4	27	Oklahoma	1.3	43	New Jersey	-0.3
11	Ohio	2.3		**United States**	**1.0**	44	Michigan	-0.3
12	Colorado	2.1	28	Virginia	1.0	45	Connecticut	-0.9
13	North Dakota	2.0	29	Alabama	0.9	46	Vermont	-1.7
14	Hawaii	1.9	30	Georgia	0.9	47	Rhode Island	-2.2
15	Alaska	1.9	31	Montana	0.8	48	New Hampshire	-2.8
16	Texas	1.8	32	Delaware	0.8	49	Maine	-3.1
17	Indiana	1.8	33	Maryland	0.7	50	Massachusetts	-3.1

Manufacturing Employment Changes: In recessions, manufacturing employment normally drops much more quickly and deeply than employment in fields like services and retailing. The extent of the drop has closely related to the severity of recession's impacts on individual states. The most vulnerable states have traditionally been the manufacturing oriented states of the Midwest, particularly those most dependent on motor vehicle manufacturing. Both car and truck purchases tend to decline in recessions. But some factors, probably the declining dollar and inventory policies of the auto manufacturers, have made this recession somewhat different. So while vehicle purchases by consumers are down sharply, manufacturing employment declines in the Midwest are less severe than in many other states.

Percentage changes in manufacturing employment are shown on Table 7, along with the total number of manufacturing jobs.

Table 7: Manufacturing Employment, October 1990 (000)
Plus Percentage Change In Manufacturing Employment, October 1989-90

Rank	State	Percent	Number	Rank	State	Percent	Number
1	North Dakota	7.6%	18	27	Alabama	-1.1%	380
2	Wyoming	5.5	9	28	Tennessee	-1.3	520
3	Utah	4.0	108	29	Hawaii	-1.4	20
4	Nevada	3.5	26	30	Washington	-1.4	366
5	Montana	3.1	23	31	Oregon	-1.6	218
6	Idaho	2.5	65		**United States**	**-1.6**	**19,129**
7	Nebraska	2.4	98	32	Pennsylvania	-1.7	1,026
8	Louisiana	1.7	177	33	California	-1.9	2,119
9	New Mexico	1.6	44	34	Missouri	-2.0	430
10	Arkansas	1.0	233	35	South Carolina	-2.1	382
11	Wisconsin	1.0	561	36	Florida	-2.3	529
12	South Dakota	0.9	32	37	Maryland	-2.5	203
13	Ohio	0.8	1,125	38	West Virginia	-2.5	85
14	Kansas	0.7	185	39	Michigan	-2.6	939
15	Delaware	0.6	71	40	North Carolina	-2.9	844
16	Colorado	0.3	195	41	Georgia	-2.9	554
17	Arizona	0.3	188	42	Connecticut	-3.2	346
18	Alaska	0.0	13	43	New Jersey	-3.4	630
19	Indiana	-0.1	635	44	Virginia	-3.4	415
20	Illinois	-0.2	979	45	Maine	-3.6	103
21	Kentucky	-0.3	285	46	New York	-3.8	1,146
22	Texas	-0.5	966	47	Rhode Island	-4.1	104
23	Mississippi	-0.5	243	48	New Hampshire	-4.8	106
24	Oklahoma	-0.6	162	49	Massachusetts	-6.1	522
25	Minnesota	-0.8	398	50	Vermont	-7.1	44
26	Iowa	-1.0	234				

The top gains are in the states with relatively small manufacturing sectors which don't have much impact on the overall condition of their state's economies. The other gainers, in the face of a 1.6% loss in manufacturing jobs nationwide, include Arkansas, Ohio, and Wisconsin. For recession conditions, it is unusual to find the job loss in states like Indiana and Illinois below the national average for job loss.

Federal Aid: In past recessions, there have been federal programs designed to put people back to work. Some of these, particularly a tax cut, are presumably clearly precluded by the federal fiscal situation. There are already signs of support for some expansion of federal spending. One would revive the past practice of extending unemployment compensation benefits. When workers exhaust their benefits (normally in 26 weeks), they would receive federally funded extended benefits running for up to an added 13 weeks. This action wouldn't affect state general fund budgets, but the funds would flow through state-administered UC funds. Another idea is to put

additional money into infrastructure, such as permitting accelerated spending under existing programs, particularly the highway trust fuund. A more remote possibility is to put new federal money into public works construction. Such programs have, in the past, tended to have so much paperwork that their effects have been felt after the recovery from recession, not as recession-fighting measures.

Unemployment Trust Funds: As unemployment rates rise, disbursements from state unemployment compensation trust funds increase while income to the funds, from a payroll tax, tends to fall. If the result exhausts the fund, funds can be borrowed from the federal government with interest. States try to maintain reserves to avoid the need to borrow. But state officials and the labor and business leaders who influence the decision are also sensitive to the higher taxes needed to build up reserves. So state policies on reserves differ. So does the severity of the economic downturn each state faces and how well it was anticipated. It appears that Connecticut and Massachusetts will have to borrow in 1991 -- perhaps to be joined by some Midwestern states like Michigan, Minnesota, Missouri, and Ohio.

Under current ground rules, each state's payroll finances its UC payments, except when the federal government provides extended benefits to fight recession. From time to time, there is discussion of plans by which the states would, in effect, insure each other. For a discussion of these plans as well as state strategies on how much to put in UC reserves, see Wayne Vroman's Unemployment Insurance Trust Fund Adequacy In The 1990s (Upjohn Institute, 300 S. Westnedge Ave., Kalamazoo, MI 49007, 1990).

REGULATION OF FINANCIAL INSTITUTIONS

Introduction: Recent events support conclusions that state regulation of financial institutions is failing, but on examination the evidence isn't overwhelming.

Solvency Of Insurance Companies: Problems with state regulation of insurance companies are featured in "Regulator's Failure To Halt Insurer's Slide Shows Flaws In System" (Wall Street Journal, 12/31). The article is generally critical of state regulation, particularly Pennsylvania's. It illustrates the difficulties states have in dealing with companies headquartered in other states. The company, Lacop, ultimately proved unable to honor its claims. Letting its affairs get as bad as they did was conceded by Pennsylvania regulators as their failure.

Insurance buyers were protected in some states, which made independent decisions that the company couldn't sell policies there. Those states were Ohio, Illinois, Tennessee, and California. But many of the policies were sold in West Virginia which, unlike the others, decided to honor Pennsylvania's decision that the company could continue to operate. The article includes some indictments of state regulation and discusses pressure for federal action. But editorially, in the same issue, the paper asserts that federal performance in regulating S&Ls suggests federal takeover of insurance regulation wouldn't be helpful.

Forbes (1/7) ends its discussion of state insurance regulation with the comment:

> It's tough being a regulator in times like these. Err on the side of looseness, and you risk getting blamed for insolvencies. Err on the side of rigidity, and you risk restricting capital flows that create jobs and economic activity.

It its article, the magazine is critical of state regulators for tough guidelines on insurance company investments in junk bonds and other securities.

Financial Institutions Without Federal Insurance: Rhode Island's new governor made national news within two hours of being sworn in when he ordered the closing of 45 banks and credit unions. The news was less significant than it sounded because the bulk of Rhode Island banking is handled by 38 institutions in Rhode Island that have federal insurance and weren't affected by the closings. The institutions involved include two small conventional banks and eight "loan and investment banks." They are comparable to the industrial banks that created a crisis ultimately resulting in a bailout by Nebraska in the mid-1980s. Most states either never had such institutions or have forced them to assume characteristics of conventional banks and seek insurance from the Federal Deposit Insurance Corporation.

The remainder are credit unions. Large credit unions, accounting for about 97% of credit union deposits nationally, are regulated and insured by the National Credit Union Administration. Most states have forced credit unions, or all but tiny ones, into this federal program, but some state insurance remains comparable to the Rhode Island Share and Deposit Indemnity Fund. Besides Rhode Island, Massachusetts and Pennsylvania are apparently the only states with any form of state-insured banks and S&Ls.

The number of credit unions without federal insurance is shown on Table 8 (data from National Association of Share Insurance Corporations appearing in USA Today, 1/3, the listing differs substantially from one appearing on the same date in the Wall Street Journal that is attributed to a private financial publishing company). The table suggests that several states have a larger exposure than Rhode Island.

Table 8: Number and Deposits ($ million) of Credit Unions That Lack Federal Insurance, 1990

State	Number	Deposits	State	Number	Deposits
Massachusetts	136	$2,888	Ohio	176	$835
Texas	287	2,530	Indiana	26	343
Illinois	73	2,145	Kansas	68	219
Florida	121	1,589	Nevada	7	165
Tennessee	190	1,539	Maryland	13	61
Washington	97	1,487	Idaho	28	53
Rhode Island	35	1,333	West Virginia	13	38
California	33	1,156	Iowa	2	7
Georgia	98	1,191	Oklahoma	1	7
Missouri	57	1,048	Wisconsin	1	5

After a problem with one of the state-insured institutions in November, Rhode Island was encouraging its insured institutions to seek federal insurance. But depositors weren't convinced, so they began a "run" on the state-insured institutions. The assets of these institutions, consisting largely of long-term loans, and the assets of the state's fund, may or may not be enough to cover all deposits in the long run. But in the short run, they couldn't cover the widespread demand by depositors to get their money immediately.

Will All States Drop Insurance Activities? It will take a while to sort out the Rhode Island situation. But it doesn't appear likely to be as serious as the failures of the state-insured S&Ls in Maryland and Ohio in the mid-1980s. At a minimum, depositors will have to suffer a period in which they cannot withdraw their money, and may not earn interest during that period. At worst, there will be pressure on the Rhode Island legislature to use taxpayer money to make good on the failures of the state insurance fund. The situation may cause other states to reassess the continuation of state-chartered financial institutions that aren't required to participate in federal insurance programs.

Federal Insurance And State Regulation: The interaction of the state authority to charter financial institutions with the federal programs of deposit insurance continues to cause friction. The 1989 federal legislation on S&Ls provided exceptions for savings banks, state-chartered institutions of which there were about 500 compared with 12,000 regular banks and S&Ls. Some S&Ls started seeking the broader authority of savings banks by attempting to convert to savings bank charters in the states that permit them. Legislation was also sought in other states to permit savings banks, an effort which the head of the federal Office of Thrift Supervision called "blatant attempts to evade the reforms enacted by Congress." Such laws passed in Illinois, Indiana, and Louisiana and probably some other states.

Banks In The Insurance Business: There has long been a dispute between banks and insurance companies over whether banks should be able to sell insurance. For banks chartered by states, this is a question of state law. This summer, Delaware enacted legislation allowing banks chartered by the state to sell insurance. Upon the signing of the legislation, major banking corporations, like Chase Manhattan and Citicorp, indicated they would be using the new power. Delaware's action makes it the second state to grant this broad power. South Dakota took a somewhat similar action some years ago, but its effect was tied up by Federal Reserve Board action, a contingency that could limit the effect of Delaware's action as well.

Bank Solvency: Essentially all major banks have federal insurance. So, unlike the situation with insurance companies and credit unions in some states, state finances are not at risk from any bank bailouts. However, the federal insurance fund is at risk. That fact and fear of a repetition of the S&L debacle have caused a significant tightening of federal bank regulation. It affects a variety of bank practices, particularly the classification of problem loans. That decision interacts with reserve requirements and the psychology of the industry to produce what many observers say is a significant tightening of bank lending. This can have major effects on state economies, at least this has been the view of some New England governors and Members of Congress who have expressed concern that regulatory pressures will cause further regional recession.

Because some of the alleged effects are psychological, it is difficult to quantify the situation in individual states. Table 9 attempts to provide an indication of relative severity by using research from USA Today (5/29) and Federal Deposit Insurance Corporation data to show capital as a percentage of assets.

Table 9: Bank Capital As Percentage Of Assets, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	9.94%	18	South Dakota	7.47%	35	Idaho	6.55%
2	West Virginia	8.91	19	Missouri	7.39	36	Minnesota	6.55
3	Iowa	8.86	20	New Mexico	7.36	37	Connecticut	6.52
4	Wyoming	8.59	21	Utah	7.36	38	Illinois	6.48
5	Delaware	8.51	22	Vermont	7.33	39	New Hampshire	6.48
6	Arkansas	8.46	23	Tennessee	7.26	40	Michigan	6.43
7	North Dakota	8.29	24	Colorado	7.18	41	Massachusetts	6.32
8	Nebraska	8.19	25	Maryland	6.97		**United States**	**6.31**
9	Kansas	8.11	26	Rhode Island	6.91	42	Florida	6.31
10	Mississippi	7.98	27	Ohio	6.86	43	Hawaii	6.26
11	Alabama	7.95	28	South Carolina	6.84	44	North Carolina	6.21
12	Georgia	7.81	29	Washington	6.82	45	Nevada	6.16
13	Kentucky	7.78	30	Oregon	6.79	46	California	6.03
14	Wisconsin	7.75	31	New Jersey	6.63	47	Pennsylvania	5.97
15	Montana	7.70	32	Louisiana	6.57	48	Arizona	5.33
16	Oklahoma	7.63	33	Maine	6.57	49	New York	5.17
17	Indiana	7.49	34	Virginia	6.57	50	Texas	4.60

The table shows a reasonable correlation between bank problems and state economic problems as measured, for example, by employment change shown on Table 6. But the correlation isn't perfect. For example, Texas banks show low capital strength despite the Texas economic recovery, though banks in neighboring Oklahoma are in the top third of the states. Generally, the capital strength appears in states that haven't enjoyed rapid economic development over the past five years.

MISCELLANY

State Employee Compensation: As happens when **Reports** runs data on state salaries, as in Issue 20, there are complaints that the whole story isn't being told. This is more true in some cases than others.

For most employees, the stated salary is comparable to private salaries. As a result, it is not equal to annual average compensation for employees who receive overtime. Overtime is common with public safety personnel and, depending on staffing patterns, with institutional personnel such as corrections officers. It is also not true for persons receiving supplemental compensation for work during the year and/or summer work, as is true for a substantial number of teachers. No stated salaries, in public or private surveys, include non-cash compensation such as health care benefits.

A few state employees, such as some state park and mental health institution executives and maintenance personnel, receive housing for which they don't necessarily pay market values, which are hard to

establish. So do governors, who typically receive lodging and some portion of their food. The arrangements vary from state to state and governor to governor so no one keeps track of them. Legislators receive so much special compensation in many states (e.g., special session pay, vouchered and unvouchered per diem pay, special pay for leadership and committee posts) that comparable numbers are difficult to obtain.

A few states allow private supplements of public pay in a few key positions, a practice prohibited by law at the federal level and in some states. For example, a private firm might supplement the pay of a state development director or a hospital might supplement the pay of a health director.

Undoing School Aid Formulas: New Jersey and Virginia illustrate contrasting aspects of changing school aid formulas that have already been enacted.

Virginia's problem arises because it has already enacted its FY 1992 budget as part of the biennial budget decisions made early in 1990. Since then the fiscal situation has deteriorated significantly. The governor's austerity measures dealt with the FY 1991 shortfall by devices not likely to cause public outcry, such as eliminating lottery funding for capital projects and using the money to avoid cutbacks in state operations. For FY 1992, more substantial actions are necessary. Part of the governor's response is to propose substantially higher percentage cuts in state aid in the affluent counties (e.g., those around Washington, DC) than in the less-affluent, predominantly rural, counties.

New Jersey's problem comes because the equalization aspects of the 1990 legislation haven't been popular. An inherent result of equalization is that the affluent districts must pay more from local taxes if they wish to maintain their above-average per-pupil spending. One mechanism causing this result is requiring about 150 affluent districts to absorb, over a five year transition, roughly $400 million in pension costs previously funded by the state. Skipping the first year of absorption has been suggested as a way to attenuate some of the adverse reaction to the total package -- which tends to hit affluent taxpayers through income taxes, sales taxes, and, depending on where they live, property taxes.

Community Development: The National Conference of State Legislatures recently released NCSL Community Development Survey, a survey of state community development policies. The 12-page survey report contains no analysis of advantages and disadvantages of particular policies, nor any state-by-state listings. Instead there are tabulations of the number of states with programs of various kinds, ranging from economic development, to housing, to job training. The authors find some legislatures are attempting to put these together as a community development strategy, but "the majority of legislatures are

still viewing the elements of community development as separate and unrelated to a comprehensive strategy."

Homeownership: The percentage of households that own their homes was 64% nationwide, according to recent Census Bureau statistics. This represents a slight drop from the 66% rate in 1980. The state rates are shown in Table 10.

Table 10: Homeownership Rate, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	74.8%	18	Minnesota	68.3%	35	Georgia	64.7%
2	Maine	73.6	19	Indiana	68.2	36	Florida	64.4
3	Michigan	73.2	20	Kansas	68.1	37	Washington	64.2
4	Pennsylvania	72.8	21	Montana	67.9		**United States**	**63.9**
5	Mississippi	72.2	22	Alabama	67.6	38	Arizona	63.9
6	Oklahoma	71.4	23	Tennessee	67.3	39	Missouri	63.7
7	South Carolina	71.0	24	Nebraska	67.2	40	Oregon	63.4
8	Utah	70.4	25	North Dakota	67.1	41	Illinois	61.9
9	Idaho	70.2	26	New Hampshire	67.0	42	Rhode Island	61.2
10	Virginia	70.2	27	Connecticut	66.4	43	Texas	61.0
11	Vermont	69.7	28	Arkansas	66.3	44	Massachusetts	58.9
12	Iowa	69.6	29	Louisiana	66.3	45	Alaska	58.7
13	Ohio	69.6	30	South Dakota	65.8	46	Colorado	58.6
14	Wyoming	69.6	31	New Jersey	65.7	47	Hawaii	54.7
15	North Carolina	69.4	32	Maryland	65.5	48	Nevada	54.3
16	Wisconsin	69.3	33	New Mexico	65.5	49	California	53.6
17	Delaware	68.7	34	Kentucky	64.9	50	New York	52.3

Homeownership has been an objective of national housing policy for decades. It generally correlates with a propensity to vote and is inversely related to crime rates. But these relationships with homeownership aren't necessarily proof that homeowership itself would cure significant social problems. Homeownership tends to correlate with age, as does voting and refraining from committing crime. The age relationship explains some, but not all, of the state rankings. Among householders over age 50, 77% owned their homes while the rate was 39% for those under age 35.

TECHNICAL NOTES

Economic Development: The Review is published by the Corporation for Economic Development (777 North Capitol St., NE, Washington, DC 20002). Besides the article cited, other approaches to "third wave" development are presented in the issue, including articles by Walter Plosila (Montgomery (MD) High Technology Council) and Richard Hatch (Manufacturing Network Project). In June, Governing published an article, "A Third Wave of Economic Development," by John Herbers which

featured programs in Pennsylvania, North Carolina, and Michigan and Ross's comments on the principles of the third wave. Ross's perspectives are also featured in Points West (Spring 1990, Center for the New West, 600 World Trade Center, 1625 Broadway, Denver, CO 80202). Ross and David Osborne contributed "Catching The Third Wave" (Washington Post, 7/22/90).

Enterprise Zones: A recent review of enterprise zone proposals from a federal perspective is Federal Enterprise Zones: A Poverty Program For The 1990s? (Brett Birdsong, Urban Institute). Birdsong suggests that a program of investments in human resources in target areas would be preferable to the zone proposal being considered at the federal level. He concludes, "Careful evaluations of state enterprise zone programs have found no evidence that incentives have contributed to employment or investment growth in designated areas. In the zones where growth has occurred, it cannot be attributed directly to enterprise zone incentives."

The annual evaluations of the Indiana program are likely to be especially of interest to **Reports** readers because they are done by James Papke, who has been used as a consultant on tax policy by about half the states. The latest is The role of Market Based Public Policy In Economic Development And Urban Revitalization: A Retrospective Analysis And Appraisal Of The Indiana Enterprise Zone Program (Krannert School of Management, Purdue University, West Lafayette, IN 47907). The 135-page report finds no provable relationship between the tax incentives and job creation, that few jobs go to the intended target population, and that the cost per job is high. It suggests the current Indiana enterprise zone tax preferences are "expensive, regressive, and ineffective."

High Tech Incentives: The survey was printed in Site Selection (7/1990).

Evaluation: The quotation is from Harry Hatry. Mark Fall, Thomas Singer, and Blaine Liner, A Manual: Monitoring The Outcomes Of Economic Development Programs (Urban Institute, 1990). The manual is several hundred pages of information on evaluating development programs produced by the Institute in cooperation with the states of Maryland and Minnesota. For an example of the types of detailed assessments that some states have undertaken, see Mt. Auburn Associates (408 Highland Ave., Somerville, MA 02144), The Economic Impact Of Business Financing By New York State Agencies.